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PROPOSED TREASURY DEPARTMENT'S TAX SIMPLIFICATION PLAN ON THE OIL AND GAS INDUSTRY

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON THE

PROPOSED TREASURY DEPARTMENT'S TAX SIMPLIFICATION PLAN ON THE OIL AND GAS INDUSTRY

NEW ORLEANS, LA, MARCH 15, 1985

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PROPOSED TREASURY DEPARTMENT'S TAX SIMPLIFICATION PLAN ON THE OIL AND GAS INDUSTRY

FRIDAY, MARCH 15, 1985

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
New Orleans, LA.

The committee met, pursuant to notice, at 2 p.m., in En Banc Courtroom 209, U.S. Court of Appeals Building, New Orleans, LA Hon. J. Bennett Johnston, presiding.

Present: Senators Johnston and Long.

Also present: E. David Doane, senior counsel; Elizabeth Moler, counsel for the minority; Daryl Owen, administrative assistant to Senator Johnston; Cindy Shade, legislature assistant to Senator Johnston; and Kris Kirkpatrick, administrative assistant to Senator Long.

OPENING STATEMENT OF HON. J. BENNETT JOHNSTON, A U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator JOHNSTON. Ladies and gentlemen, I am pleased to be able to convene this meeting of the Senate Energy and Natural Resources Committee, the purpose of which is to examine the new Treasury plan for the so-called flat tax, otherwise called the fair tax or the simple tax.

I'm especially glad that my senior colleague, who is the ranking Democrat on the Finance Committee, could join me in this hearing, because obviously the Finance Committee is the committee that has primary jurisdiction over taxes.

It is the Energy and Natural Resources Committee, of course, in which we have primary jurisdiction over energy.

When I first heard about the so-called fair and simple tax, the rhetoric around it was so appealing that I, along with most of my colleagues, thought that there must be something very fair and good about this tax.

So I began to look at it, and upon very quick examination was able to determine that the so-called fair and simple flat tax is neither fair, nor simple, nor flat.

Indeed, it would make a very complicated Tax Code even more complicated by the time you consider the transition rules.

But we are not here to consider complication or difficulty. What we are here to do today is to consider what this so-called flat tax would do to the oil and gas industry.

As all of you know, the oil and gas industry is now in the hospital. If the flat, simple tax were passed, it would be in the morgue.

It is not too much to say, in my judgment, that the so-called fair tax would put a padlock on oil and gas drilling in the domestic United States. It is already a very chancy and a very difficult business to be in. It is already one where drilling is off, where employment is off, where severance taxes are off; and if this tax were passed, it would deal what I believe would be perhaps a mortal blow to the oil and gas industry.

I think the Treasury Department understands what this tax would do to the oil and gas industry. Their response is: "Yes, it would be difficult, but the capital which would be released and the personnel which would be released by this," they say, "would more efficiently be applied elsewhere."

Translated, what they are saying is that after people in the oil and gas business go broke in the oil and gas business, and after people lose their jobs in the oil and gas business, that elsewhere they could perhaps find employment, which in the opinion of the Treasury might be more worthwhile.

If that is truly their view, and that indeed is the view that has been printed from the Treasury Department, I think they have not really considered the strategic importance of having a domestic oil and gas business.

How short are our memories in this country? Only a very few short years ago we were having a tremendous shortage of oil and gas, with prices going through the roofs. We were beginning to build a strategic petroleum reserve, because we equated the importance of domestic oil and gas as a strategic matter, a matter of national defense if you will.

Today, we are here talking about a plan which would effectively shut down domestic oil and gas drilling. In a related matter, just yesterday the Senate Budget Committee passed a plan which would stop the filling of the strategic petroleum reserve.

We are here today to find out the facts. I believe that the facts will be as I have stated them to those witnesses here who are experts in the industry, but we are here to find out the facts and to build the record for or against the so-called flat tax.

I believe the facts will speak for themselves eloquently and strongly against this proposition.

[The prepared statement of Senator Johnston follows:]

OPENING STATEMENT BY SENATOR J. BENNETT JOHNSTON

COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
FIELD HEARING ON THE EFFECT OF THE TREASURY TAX PLAN
ON THE DOMESTIC OIL AND GAS INDUSTRY
MARCH 15, 1985 - NEW ORLEANS, LOUISIANA

I am pleased to be able to convene this hearing of the Senate Energy and Natural Resources Committee to take testimony on the effect of the Treasury Department's tax plan on the domestic oil and gas industry. I am particularly pleased to have my senior colleague, Senator Russell Long, with me here today.

The Treasury Department proposal was conceived in Washington by those whose overriding objective is to do what they call "rationalize" federal income taxation. They contend that their proposed reforms will be "beneficial in the long run because the capital and labor released from the energy and mineral sector as a result of a more neutral tax policy would be employed more productively in other industries."

As far as I am concerned, they are dead wrong. I believe that the proposal represents a very serious threat to the energy industry. Indeed, it would virtually padlock the oil and gas industry. Its ripple effect on our economy would be devastating. Because a healthy, thriving energy industry is vital to this Nation's well being, the plan could ultimately affect our national security.

All of us agree that the present system is unfair and too complicated. All of us want fair taxes. All of us seek to reform an overly complicated tax system.

But the Treasury tax plan is an absolutely unacceptable way to accomplish those objectives.

We have two purposes here today. First, we want to give those who would be the most directly affected by the proposal an opportunity to be heard on the record about what its effect would be. My opening comments obviously reflect what I believe the effect will be. But we need good solid evidence of what it would do from those in the industry if we are going to be able to make our case that the Treasury plan needs to be changed.

The Treasury plan is reportedly undergoing review at the highest levels of the Reagan Administration. I sincerely hope that it will be changed before they actually send their proposal to Capitol Hill. We will certainly make the case for changing it. But if they do not change the proposal, we will need all the ammunition we can get to fight the proposal. Today's testimony should meet that purpose as well.

At first I did not worry about the proposed tax. But now I am genuinely worried and believe it is time to sound the alarm. I look forward to hearing what our witnesses have to say and to working with you to make sure that it does not get enacted.

Senator JOHNSTON. I am glad to welcome my senior colleague, who will be a strong and effective Member of the U.S. Senate for another 2 years. I wish it were another 20 years, but you can count on him being a strong voice for the next 2 years.

Senator Long.

STATEMENT OF HON. RUSSELL B. LONG, A U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator LONG. Thank you very much, Senator Johnston.

Everything that I have heard from those in the oil and gas industry, the production end especially, is consistent with what Senator Johnston has just said about the impact of the proposed simplification bill, or the modified flat tax, or the many other names that have been used to describe the Treasury's proposal.

We'll have the witnesses today who will state for themselves and to their best knowledge how the impact will be felt in Louisiana and how it will be felt by those whom they represent.

I am personally satisfied that the bill must not pass with the recommendations that so adversely affect this basic and vital industry for the United States.

So I look forward to the testimony, and I will do what I can to see to it that any defects in the bill, and there are quite a few, would be corrected and, hopefully, make a good piece of legislation out of one that might not be so good in the beginning.

I appreciate my colleague arranging for this hearing here in New Orleans under the sponsorship of the Energy Committee, to whom he will report the results of the hearing.

I'll see to it that the Finance Committee knows about it.

Senator JOHNSTON. Thank you very much, Senator Long.

Before we hear from Congressman Breaux, who is our first witness, I would like to welcome Congressman Billy Tauzin, who is our neighbor in the House and a member of the Energy and Commerce Committee of the House of Representatives.

Mr. TAUZIN. Thank you, Bennett.

Senator JOHNSTON. Would you like to say a word?

STATEMENT OF HON. BILLY TAUZIN, A U.S. REPRESENTATIVE FROM THE STATE OF LOUISIANA

Mr. TAUZIN. I certainly don't want to jump in front of Senator Breaux. [Laughter.]

The hearing on this matter is extremely important to this State because of the implications of the provisions that Russell has pointed out. Thank God, we still have Russell Long on the Finance Committee of the U.S. Senate in the 99th Congress, because those provisions and the implications of those changes indeed are tremendous in terms of independent oil and gas operations in this State and this country.

We are glad to have the majors here who are operating in Louisiana and in this country, but I recall when the OPEC oil embargo was around and this State needed gasoline supplies, I remember the independent oil and gas community was the one that came to our aid and made extra supplies available to us.

Having them there is not only an important economic advantage to this State, but it's also a great advantage to consumers of this State and this Nation. I would hate to lose that vital component of the energy production system.

So Russell, we are all going to watch it with you, but we are specially counting on you. You were careful to remind me that you are still our Senator for the next 2 years. I am just anxious and glad that you are there, because this will be a critical year for us in tax legislation.

I am anxious to hear what Senator Breaux has to say.

Senator JOHNSTON. Thank you very much, Congressman Tauzin.

We would like to welcome our outstanding colleague from the House, our neighbor from Lakes Charles and Lafayette. What is this "Senator" Breaux? I keep hearing that all over town. There must be something very strong to it. [Laughter.]

Congressman John Breaux.

STATEMENT OF HON. JOHN B. BREAUX, A U.S. REPRESENTATIVE FROM THE STATE OF LOUISIANA

Mr. BREAUX. Thank you very much, Mr. Chairman, and let me join in welcoming all three of our colleagues from the Louisiana delegation who have decided to do what I think is very important.

I think that this tax bill should not be written in the basement of the Treasury Department. It should only be written after a great deal of time and effort is given to learning the views and the feelings of the people out in the field.

I appreciate what Chairman Johnston has said about the very valuable service of our colleague, Russell Long. I, too, particularly over the last 2 weeks, wish that you would be able to serve for another 20 years, I want you to know.

I think that the three most difficult tasks, someone once told me was, first, to try and climb a wall that's leaning toward you; the second most difficult task was trying to kiss a girl that's leaning away from you; and the third most difficult task is to try and speak to a group that knows a lot more about the subject than you do.

I sort of find myself in that position. Our colleague, Billy Tauzin, is a distinguished Member in the House on the Commerce and Energy Committee, which is very deeply involved in a program to try to become energy self-secure.

Senator Long, you have practically written the Tax Code with regard to energy legislation and the very technical ingredients in that area.

And Senator Johnston, of course, is serving as the senior Member in the whole U.S. Senate on the Energy Committee.

I would think that the people who are concerned about the particular problem that we are facing would feel very secure to have all three of you gentlemen participate in the writing of that package. They would understand that you understand their problems, and you understand what the needs are.

Back in my area, and probably in Billy's area, too, if you've got something that's really bad and you want to try and sell it—like castor oil or something like that—you try and call it something else.

If you try and call it honey, maybe you'll get a few people to buy it and maybe even to taste it. The problem is that once you take the cap off, you find out that the honey is not honey at all, but it's castor oil and it's really bad for you.

In law, I think if you try—and want to sell something that really isn't that good--you say: "Let's call it a reform." There are more bad laws that all of you gentlemen and I have seen passed in my 13 years in the House and your service in the other body that have been passed because they have been called reform; and if anybody ever took the lid off and really looked at it, we could come to the conclusion that it's not really reform, that underneath that sugar coating there are some real problems lying to take the toll of the constituencies that they affect.

Now, people behind me and after me are going to go into some of the details on the tax simplification/tax reform bill that has been presented on behalf of the administration. They are going to be able to tell you in specific details, I think, about the problems, and I welcome their testimony.

But from a congressional viewpoint of a person who represents men and women in Louisiana, who are in the oil industry, who are doing our job to try and create a situation where we are energy independent, I think this so-called tax simplification bill comes at the worst possible time.

I agree with the chairman that if it were enacted in the form that it is presented, it would be a devastation on the people in the oil and gas industry in Louisiana, and I dare say throughout the United States of America.

Not only that, it comes at the worst possible time. The energy-producing industry in this country has suffered a great deal because of the uncertainty in the industry; they have suffered from not knowing what's going to be down the road 6 months from now or 1 year from now.

What we have now is another ingredient that has been thrown out on the table that is very uncertain. If it were enacted like it is, in my opinion it would be the disaster that Senator Johnston has said it would be.

I noticed a headline in the paper just this week in Louisiana, "2,400 Oil Jobs Lost in Three Years." That's in Louisiana, just in our State, and that gives an indication of the great recovery some people are talking about. It's not a strong recovery. It's one in fact that is costing us jobs in Louisiana.

The State knows quite well the effect on the revenues in Louisiana as they dwindle down and down because of lost production.

You just have to look over the Treasury tax bill and read a quick summary of the things that it illuminates, and I would come to the same conclusion as economists that have looked at it would say, and that is that the effect would be completely and totally unacceptable.

The percentage depletion allowance is repealed; the expensing of the intangible drilling costs is repealed; the dry-hole costs could be written off only at the time the property is abandoned instead of the procedures that we have today; the expensing of the qualified tertiary injection expenses would be repealed; the investment tax credit would be repealed; the accelerated cost recovery system would be repealed; and limited partnerships would be taxed as corporations.

All of these are essential ingredients to allow companies to expand and to produce energy that is necessary for the country.

The studies that I have shown indicate very clearly that you are talking about a dramatic decrease in the amount of energy produced in this country, if the bill were enacted.

I question whether that is a good policy to get this country moving toward energy self-sufficiency.

I would just urge my colleagues, and I know that you are in fact doing the job that needs to be done. You are listening to the people who have to face these provisions and operate under them. I know that you, hopefully, will be able to do what is necessary to bring about a sound package.

On the other hand, I would just mention what all of you have been deeply involved in, along with myself, and that is the fact that on the one hand, the Federal Government is trying to change the Tax Code which would do damage to Louisiana, and at the same time the Department is sitting on $6 billion in an escrow account in Washington, some of which belongs to Louisiana. The figure that we have for the portion owed to our own State of Louisiana is $2,186,347,839.31. That money has been earmarked as ours since December 1984. It's our portion of the share of the leasing revenues for the so-called 8(g) tracts. That is really money that fairly belongs to the State of Louisiana.

So in this case we are being hit with a double dose of something that's not very tasteful, the change in the Tax Code at a most inopportune time, and still not releasing the funds that are necessary and rightfully part of the share that Louisiana deserves.

So, Mr. Chairman, I thank you for having the hearings. Senator Long and Congressman Tauzin, thank you for participating and showing your concern for what the administration is proposing.

I would be glad to respond to any questions, Bennett, that you might have.

Senator JOHNSTON. Thank you very much, Congressman Breaux. Along the lines of what you are saying, I'd like to put into the record at this point a memorandum from T. Boone Pickens, Jr., a person with whom I have on occasion had disagreements; but on the subject of what he writes me now, I very strongly agree.

He says in a memo dated March 7 that, "The rig count is now down to 2,011 nationwide, which is down 132 from the previous week." He forecasts that it will probably hit the all-time low of 1,807 set in April of 1983.

He also states that, "There will be a continual deterioration of the price in oil and gas in the world, which oversupply has compounded, and the drop will cause further oil industry cutbacks."

As he says: "In Texas oil and gas payrolls are lean and planners are anticipating a continuation of falling oil prices and a depressed rig count."

We'll put that in the record at this point, and I think the points you make are very valid and absolutely in line with the facts in the case.

[The memorandum follows:]

MESA
PETROLEUM CO.

1985 MAR 11 AM 6 48

TO: The Honorable J. Bennett Johnston, Jr.

FROM: T. Boone Pickens, Jr.

SUBJECT: U.S. Rig Count*

DATE: March 7, 1985

Week	Count	Change From Previous Week
March 4, 1985	2,011	Down 132

Comments:

The U.S. drilling rig count will likely fall to a new low during 1985. The entire industry must approach the decade ahead with the realization that we won't return to good old days, when we had 4,500 rigs operating. In fact, it's very probable that this year the rig count will dip beneath the low of 1,807 set in April 1983.

The rig count is the basic barometer of the oil industry's health. We have been identified as a "sunset" industry because of the inability to replace reserves at a reasonable cost. The continual deterioration of the price of oil and gas in a world of oversupply has compounded the problem. The Texas Comptroller's Office predicts oil prices will continue a downward trend. The drop will cause further oil industry cutbacks. In Texas, oil and gas payrolls are lean, and planners are anticipating the continuation of falling oil prices and a depressed rig count.

*Data compiled and reported by Hughes Tool Company.

ONE MESA SQUARE / POST OFFICE BOX 2009 / AC 806/378-1000 / AMARILLO, TEXAS 79189-2009

Senator Johnston. Do you have any questions, Senator?

Thank you very much, Senator Breaux.

Next we have an outstanding member of the Louisiana Senate, who is also reputed to be a candidate. This is not supposed to be candidate's hour. We picked our witnesses elsewhere, but it's reputed that Tommy Hudson, now the president pro tem of the Louisiana Senate will be the next Congressman from Baton Rouge.

Having given him his first job, I'll be very pleased to see that.

So, Senator Hudson, we are glad to welcome you here.

STATEMENT OF TOMMY H. HUDSON, STATE SENATOR AND PRESIDENT PRO TEMPORE, LOUISIANA STATE SENATE, BATON ROUGE, LA

Senator Hudson. Thank you for those kind words, and it is a pleasure for me to be here and have an opportunity to respond to this proposal. Thank you on behalf of the people of Louisiana for giving us this opportunity to discuss the impact with you, and with Senator Long and Congressman Tauzin.

I think we all understand and appreciate the need for Federal tax reform and tax simplification. However, as the Federal Government seeks to protect its interest in the formulation of the Treasury plan, it is incumbent upon State officials to do the same for the interests of Louisiana.

Rather than duplicate the testimony of Congressman/ Senator Breaux, I would like to leave the details of the plan and the impact on the industry so important to Louisiana to those whose area of expertise it is. I prefer to discuss and illustrate very briefly with you the impact of the plan on Louisiana.

The president of the senate, Senator Nunez is here. He has provided leadership in the legislature in the area of trying to rebuild the economy of Louisiana, an economy that is facing a 4-percent unemployment rate at this time. Whereas almost 10 years ago our unemployment rate was 2 percentage points below the national average, we are now 4 percentage points above the national average, which means that there are presently over 200,000 Louisianians not working that would be working if we were only at the national average.

Senator Johnston. That rate is 11.2 percent; is that the latest figures?

Senator Hudson. That is correct.

The Treasury proposal would add an additional 130,000 unemployment or unemployed persons to the existing 4 percent, due to impacts resulting from alterations in the tax treatment in intangible drilling costs which is devastating to our efforts to rebuild the economy of Louisiana.

We are facing in the legislature at least a $125 million deficit, because of the decline in our economy and also because of the decline in severance and other related taxes from oil and gas extraction. We must make cuts up that much in order to balance the budget under the existing circumstances.

If oil drops to $22 per barrel, as is certainly within reason, that would mean a potential deficit of almost $270 million.

Senator JOHNSTON. What is your present deficit projected for this year?

Senator HUDSON. The projected is $125 million. If oil drops to $22, which is certainly within the realm of reason, that means it would be $270 million. If you add to that the $135 million in the loss of revenue due to the enactment of such a plan as we are discussing today, you can see the devastation that it would cause to the Louisiana budget and our ability to provide services.

Senator LONG. I'd like to get those figures down in writing. Would you mind running through them for me again, Mr. Hudson.

Senator HUDSON. Yes. Presently for this fiscal year, we are anticipating a $125 million deficit. As you know, in Louisiana, we cannot incur a deficit, so it's necessary for us to make those cuts.

Senator LONG. You've either got to cut spending or you've got to raise taxes $125 million.

Senator HUDSON. The taxes are impossible, so it's going to be necessary to cut.

Senator JOHNSTON. How big is the tax package just recently passed?

Senator HUDSON. In 1984 it was the largest tax package passed by this State of almost $1 billion, over $900 million.

Notwithstanding those additional taxes, the problems with the economy and the result on the revenue stream into Louisiana forces us once again to make serious cuts even if we are assuming oil at over $25 a barrel.

Senator LONG. That's the deficit that you are looking at that you are going to have to cut. You are going to have to cut spending $125 million to survive the way it is now.

Then what is the next figure that you gave us?

Senator HUDSON. That $125 million deficit figure is assuming that oil is over $25 a barrel; about $26.75 to be precise.

If oil drops to $22 per barrel in the next fiscal year, that would mean a $269-million deficit potential in Louisiana.

Senator LONG. I think you had a further figure there, or did you, an additional figure?

Senator HUDSON. Well, then upon that, the projected loss of revenues with the enactment of this Tax Simplification Plan of $135 million.

Senator LONG. Is that an additional loss?

Senator HUDSON. That's an additional loss on top of what I've already projected.

Senator LONG. Now, would you give us some indication as to why the State would lose that additional amount because of the passage of the bill.

Senator HUDSON. OK. There will be some people who are in the industry, but——

Senator JOHNSTON. I think the severance tax loss for Louisiana alone, because of lost wells, according to the Interstate Oil Compact Commission, would be $130 or $135 million.

Senator HUDSON. That is correct. I mean, it has to do with all the incentives and the projected loss in drilling activity.

Senator LONG. I see.

Senator JOHNSTON. I think Bob Brookshire is going to testify on those figures.

Senator **Hudson**. With the consequent loss in revenues to the State.

Senator **Long**. Is that in addition to the $269 million?

Senator **Hudson**. That is correct.

Senator **Long**. Well, then, you are talking about a $408-million deficit.

Senator **Hudson**. That is correct.

Senator **Long**. That would—$125 million is a pretty big cut, but a $400-million cut in spending, that will be a drastic cut on the State payroll, I would take it.

Senator **Hudson**. If you couple that with the State's effort, when you look at our colleges and universities being $122 million below the regional average, elementary and secondary education ranking toward the bottom and losing ground each year, you can see the serious reordering of priorities and the serious problems facing the State that is trying to totally reevaluate and restructure its economy, diversify its economy in order to provide jobs.

So it can have very devastating effects not only on our efforts to improve the economy, add jobs and opportunity, but also it compounds the existing problems and is devastating to our efforts to improve the economy.

Senator **Johnston**. Congressman Tauzin.

Mr. **Tauzin**. Thank you, Senator.

I wanted to understand something a little better, Tommy. In referring to the $125 million anticipated deficit, I remember recently the Governor under his line-item authority, his obligation to keep the budget in balance under the Constitution, struck 5 percent across the board, I think, from State spending.

Senator **Hudson**. I believe it was 2½ percent.

Mr. **Tauzin**. Two-and-a-half percent across the board, or some figure.

At that point, are you saying that this current year's spending is still in deficit, or are you talking about a deficit anticipated in the next year's budget that you are going to have to reduce?

Senator **Hudson**. It is next fiscal year's budget.

Mr. **Tauzin**. So that under our Constitution, you are going to end the fiscal year in July, July 1, with a balanced budget; but your problem is that in the next budget you are passing, you are $125 million short if you simply continued services under current levels?

Senator **Hudson**. That does not include any enhancement programs that would enable Louisiana to compete in this new economy, such as programs for education, economic development, so forth.

Senator **Johnston**. So what you are saying is Louisiana would need additional revenue, even if you weren't in deficit in order to enhance education?

Senator **Hudson**. We are having to make cuts merely to balance the budget. Then to say that we're going to go past those cuts to provide enhancement programs into education and economic development, it is a very difficult task for the legislature and State goverment.

But that's the challenge facing Louisiana. This compounds our almost insurmountable problem.

Mr. TAUZIN. To put it in another term, if in this session of the legislature, you froze all the expenditures at the current levels as they have been reduced by the Governor, you would still be $125 million over your anticipated income for the next fiscal year?

Senator HUDSON. That is correct, Congressman, and that is based upon oil being at 26—over $26 per barrel.

You can see what will happen if it drops to 22, and most prognostications are that that's very reasonable, and it could go lower than that.

I mean, Louisiana is in a very precarious position, and this makes it even more so.

Senator JOHNSTON. Thank you very much.

Senator HUDSON. Thank you.

[The prepared statement of Senator Hudson follows:]

SENATOR THOMAS H. HUDSON
State Senator and President Pro Tempore
Louisiana State Senate
"Tax Reform For Fairness, Simplicity, and Economic Growth"
Statement Before the Committee on Energy and Natural Resources
United State Senate
March 15, 1985

We all understand and appreciate the need for Federal tax reform and tax simplification. However, as the Federal government seeks to protect its interest in the formulation of the Treasury Department's tax plan, it is incumbent upon me as a state official to seek what best serves the citizens of the State of Louisiana.

At a time when Louisiana is desperately trying to shore up its traditional industries to buy time for economic diversification, this new tax proposal threatens to worsen an already precarious fiscal situation.

Louisiana, with an unemployment rate almost 4% above the national average, stands to lose an additional 131,368 jobs due to impacts resulting from alterations in the tax treatment of intangible drilling costs which will seriously slow oil exploration and drilling activity. Another 1,333 jobs will be lost due to repeal of the percentage depletion allowance on the costs of exploration and development which is an important source of cash flow for independent producers. This also equates to a concomitant loss in revenues to state and local governments.

Local governments, heavily dependent on property taxes, will be hard hit due to a dramatic decrease in capital investments. Sales tax revenues would also drop correspondingly. Localities are already struggling as the State is becoming increasingly unable to provide assistance as in the past and are faced with another Federal proposal to eliminate revenue sharing.

Louisiana already faces a projected deficit of over $100 million for FY 1984-85 and, if the price of oil drops to $22/barrel, a projected $269 million deficit for FY 1985-86. The portion of total state revenues derived from oil and gas production has dropped from 49% to 25% in the last year and it is projected that Louisiana will lose $135 million in tax revenues per year if this proposal is implemented. We also stand to lose an additional $1.8 million per year in severance tax payments from the removal of the percentage allowance on depletion stripper wells alone. We can ill afford such a reduction in revenue at a time when there is not enough income to maintain all state services. Louisiana's economy, which is so sensitive to the fluctuating price of oil, would suffer disproportionately under this plan.

Louisiana must seriously examine any tax "simplification" plan that will only service to complicate its existing economic problems. While this proposed tax plan may be advantageous at the national level it should not be implemented at the expense of the oil and gas industry or the states who are fighting for survival within their own economic borders.

This country places a high priority on national defense, evidenced by recommendations for increased spending for our military. We must be careful not to embark on a domestic policy that undermines this nation's security by increasing its dependence on imported oil. Lost production that will result from enactment of the tax simplification plan is calculated to be 850 million barrels. Additionally, domestic reserves would drop by the equivalent of 5.6 million barrels. This loss would be over 14 times what we have in our national strategic reserves.

Senator JOHNSTON. Next we are pleased to welcome Mr. Jim Porter, who is the Secretary of the Department of Natural Resources of the State of Louisiana.

Jim, we're very glad to welcome you here, and I know your testimony will be very interesting.

STATEMENT OF B. JIM PORTER, SECRETARY, LOUISIANA DEPARTMENT OF NATURAL RESOURCES, BATON ROUGE, LA

Mr. PORTER. Thank you, Chairman Johnston, Senator Long, Representative Tauzin, it's a pleasure to be here and present some of our views from the Department of Natural Resources to you on the impact this tax reform will have on our industry.

As you can hear from what Senator Hudson has told you, the State has severe problems, severe financial problems due to the current health of the industry. I think you can see why we have all been up talking with you and trying to emphasize the importance of some type of a settlement on the 8(g) issue, because it's critical at this point in time to get those additional dollars.

I would like to recap for the record a little about the oil and gas industry in Louisiana today. More natural gas is produced in this State and off its coast than in any other State except Texas. We run a close second to our western neighbor.

We rank third in the Nation in the production of crude oil, surpassed only by Texas and Alaska. We are producing annually about 400 million barrels of oil and 6 trillion cubic feet of gas.

The industry in Louisiana is the single largest employer in the State, paying out yearly more than $3 billion in earnings to some 120,000 workers.

The contribution in taxes is equally impressive, with severance collections in taxes in 1984 totaling more than $800 million. Add to that the $500 million that's been paid in bonuses, royalties and rentals and the State's fiscal benefits from oil and gas development amounts to the tune of about $1.3 billion annually.

Now, you have heard or you will be hearing over and over again today that the effect of the Treasury's proposals on the oil and gas industry will be devastating. I am not here to dispute that.

The analyses completed thus far suggest that with the repeal of the intangible drilling costs, removal of the percentage depletion on stripper wells and proposed changes to tax provisions encouraging enhanced oil recovery projects, we can expect in Louisiana that:

Number one, the oil and gas expenditures, and that's those expenditures that are directly related to drilling activities, will be reduced by about $2.3 billion. The time period that we're looking at is 1986 to 1991, and this is an annual average of what that impact would be.

Second, I think Senator Hudson also indicated that we would have a large loss of jobs. We estimate that it would be approximately 112,000 jobs that would be lost over that period of time.

Severance taxes, would be reduced by $135 million. I think his number was $125 million. I've heard ranges anywhere from $90 to $135 million, but that certainly is a big impact.

These impacts can be counted many different ways. However, we think they are significant measures, because coupled with our knowledge of the way this industry reacts with our State economy, they help us most to understand just what is really going to happen.

Studies by economists at LSU document that shocks to the oil and gas industry are magnified severalfold in other sectors of the economy. It is called the multiplier effect and exists as an indication of how dependent our economy's well-being is on the fortunes of this industry.

According to the studies, sales increases or decreases in the oil and gas industry are nearly matched dollar for dollar in the rest of our economy.

Similarly, increases or decreases in oil and gas earnings generate more than a dollar for dollar match in other sectors and employment effects are doubled. That is, for every one job in the oil and gas industry, two are supported elsewhere.

What does all of this tell us? Well, what we think we can expect is that the indicated impacts from the Treasury's proposal will reach deep into the economy of Louisiana.

Certainly, as suggested in the multiplier effect, no one can expect to escape the severe curtailment in activities.

An expenditure reduction of $2.3 billion will touch both the majors and the independents directly involved and then roll over into the businesses providing goods and services to those majors and independents involved in exploration activity.

I do not have to——

Senator JOHNSTON. Excuse me, Jim. If your direct jobs lost would be 112,000, and there's a multiplier effect of 2-to-1, are you suggesting that there would be a loss of over 300,000 jobs in Louisiana if this bill were passed?

Mr. PORTER. In the 112,000 number, that has got those ripple effects in it. That number is there. So the total impact would be the 112,000.

Senator JOHNSTON. Thank you.

Mr. PORTER. I do not have to remind any of you that these service companies are now marginal and probably cannot stand any further setbacks.

We are particularly concerned in this regard about the independent exploration companies which account for the greatest percentage of exploration activity in this State. The independents will probably feel the brunt of the enhanced oil recovery tax provision changes.

Add to that the overall loss of capital, and they could be driven out of business, thereby removing a vital component of the industry.

I think that in your opening remarks you indicated they are in the hospital now, and certainly this is the thing that could be a mortal blow.

Additionally, the economy of ours in Louisiana, as you have heard, is a bit battered and bruised right now, hobbling along on crutches, if you will. We in the department of natural resources are betting on a reasonably healthy oil and gas industry to help us along into the next century.

We need that much time to make the transition to an economy not so dependent on oil and gas. We are truly afraid that if the Treasury's proposals are implemented, our crutches will effectively be kicked out from under us and the day of reckoning thrust immediately upon us.

That would conclude my remarks.

[The prepared statement of Mr. Porter follows:]

UNITED STATES RIG COUNT

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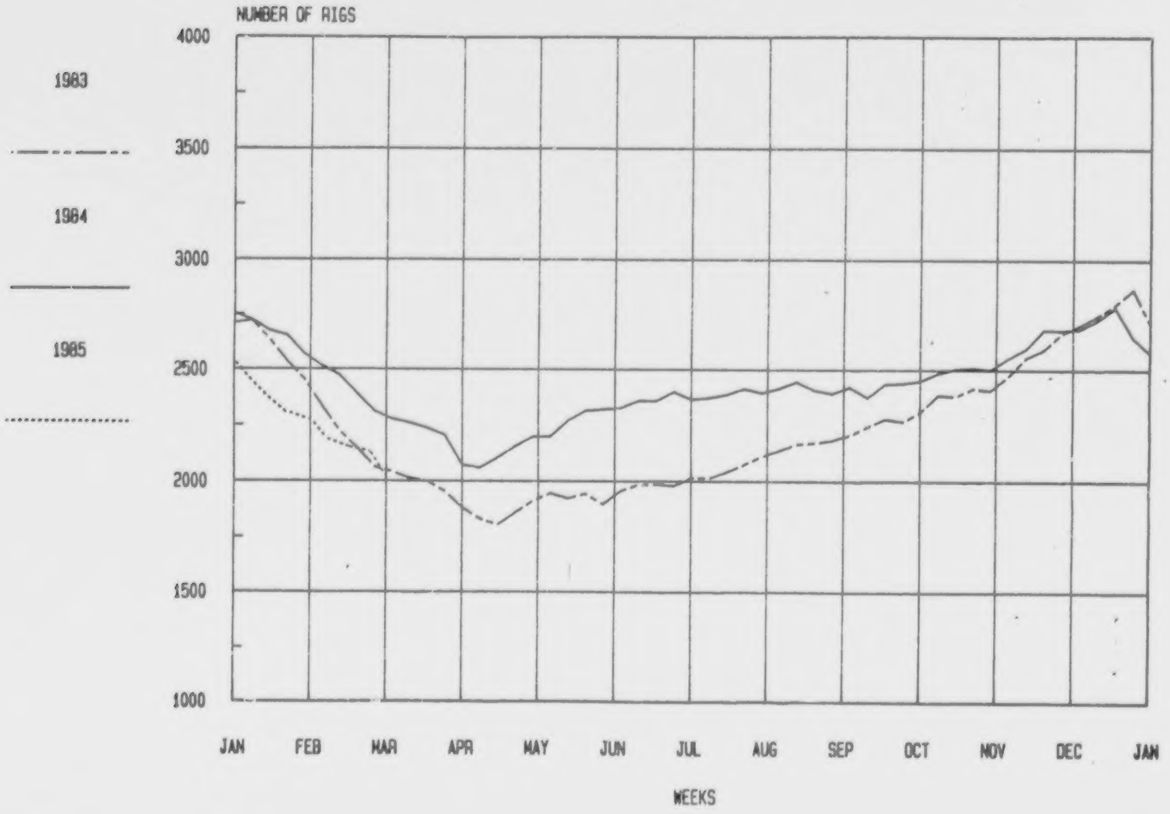

TESTIMONY OF
B. JIM PORTER, SECRETARY
LOUISIANA DEPARTMENT OF NATURAL RESOURCES

I thought I might begin by telling you a little about the oil and gas industry in Louisiana. Today, more natural gas is produced in this state and off its coast than in any other state except Texas. I might add, we run a close second to our western neighbor. We rank 3rd in the nation in the production of crude oil, surpassed only by Texas and Alaska. We are producing annually about 400 million barrels of oil and 6 trillion cubic feet of gas. The industry is the single largest employer in the state, paying out yearly more than 3 billion dollars in earnings to some 120,000 workers. The contribution in taxes is equally impressive with severance collections in fiscal 1984 totaling more than 800 million. Add to that the 500 million paid in bonuses, royalties and rentals and the state's fisc benefits from oil and gas development to the tune of 1.3 billion dollars annually.

Now, you have heard or will be hearing over and over again today that the affect of Treasury's proposals on the oil and gas industry will be devastating. I am not here to dispute that! The analyses completed thus far suggest that with the repeal of intangible drilling costs, removal of % depletion on stripper wells and proposed changes to tax provisions encouraging EOR projects, we can expect in Louisiana that:

1) oil and gas expenditures will be reduced by 2.3 billion dollars;
2) employment will be reduced by 112,000;
3) taxes will be reduced by $135 million.

These impacts can be counted many different ways, however, we think these are the significant measures because, coupled with our knowledge of the way this industry reacts with our state economy, they help us most to understand just what is really going to happen.

Studies by economists at LSU document that shocks to the oil and gas industry are magnified severalfold in other sectors of the economy. It is called the multiplier effect and exists as an indication of how dependent our economic well-being is on the fortunes of this industry. According to the studies, sales increases or decreases in the oil and gas industry are nearly matched dollar for dollar in the rest of the economy. Similarly, increases or decreases in oil and gas earnings generate more than a dollar for dollar match in other sectors and employment effects are doubled - that is, for every one job in the oil and gas industry, two are supported elsewhere.

What then does all this tell us. Well, what we think we can expect is that the indicated impacts from Treasury's proposals will reach deep into the economy. Certainly, as suggested in the multiplier effect, no one can expect to escape the severe curtailment in activity. An expenditure reduction of 2.3 billion dollars will touch both the majors and indpendents directly involved and then roll over into the businesses providing goods and services to the majors and independents involved in exploration activity. I do not have to remind you that many of these "service" companies are now marginal and probably cannot stand any further setbacks.

We are particularly concerned in this regard about the independent exploration companies which account for the greatest percentage of exploration activity in this state. The independents will probably feel the brunt of EOR tax provision changes. Add to that the overall loss of capital and they could be driven out of business, thereby removing a vital component of the industry.

This economy of ours is a bit battered and bruised right now - hobbling along on crutches, if you will. We in the Department of Natural Resources are betting on a reasonably healthy oil and gas industry to help us along into the next century. We need that much time to make the transition to an economy not so dependent on oil and gas. We are truly afraid that if the Treasury's proposals are implemented, our crutches will effectively be kicked out from under us and the day of reckoning thrust immediately upon us.

Senator JOHNSTON. Thank you very much, Mr. Porter.

Can you tell me what kind of methodology you used to determine what the cost would be in terms of jobs and in terms of dollars lost?

Mr. PORTER. This was primarily done by the IOCC [Interstate Oil Compact Commission] and they have utilized some fairly recognized economists in that. We have double checked that through some of the LSU systems that they have on impact models to verify that, in addition to models that the State senate has available, and that's how we have kind of double checked those numbers.

Senator JOHNSTON. Thank you.

Senator Long?

Senator LONG. No questions. Thank you very much for a good statement.

Senator JOHNSTON. Thank you very much, Mr. Porter.

We are pleased next to welcome Mr. Wayne Harmon, executive vice president of the Louisiana Association of Independent Producers and Royalty Owners from Baton Rouge, LA.

Welcome, Wayne.

STATEMENT OF WAYNE HARMON, EXECUTIVE VICE PRESIDENT, LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS, BATON ROUGE, LA

Mr. HARMON. Thank you, sir. With me is Robert Meredith, president of Hogan Exploration Co. in Columbia, LA.

After I finish, Robert will make a few comments and then subject himself to any questions you might have as an actual operator out there who must live under any kind of proposal that the Congress does pass.

My name is Wayne Harmon. I am the executive vice president of the Louisiana Association of Independent Producers and Royalty Owners.

We are a Louisiana-based trade association, representing about 1,500 independent oil and gas producers and royalty owners from all over the State that have a specific interest in the oil and gas business, the independent sector, in the State of Louisiana.

Today one of the most critical issues facing the State of Louisiana, and more specifically the independent oil and gas industry, is the possibility of adoption or partial adoption of the U.S. Treasury Department's tax proposal, or the Kemp/Kasten proposal or the Bradley/Gephardt proposal now pending in Washington.

We sincerely appreciate the efforts and the time taken by our Senators to come here and listen to the people in the oil and gas industry and the rest of the economy in the State of Louisiana to find out what we have to say and our suggestions toward that kind of bill.

LAIPRO has many legitimate concerns and objections to the pending proposal, "The Tax Reform for Fairness, Simplicity, and Economic Growth" issued by the U.S. Treasury Department.

It is inconceivable to us that in today's ever-changing marketplace that the U.S. Treasury Department would propose and suggest the elimination of capital gains, investment tax credits, depletion allowance and intangible drilling costs.

The eliminations would have a serious and detrimental effect on the future investments and the cash flow availability in this high-risk industry.

The proposal would virtually eliminate the future role of the independent oil and gas operator and the drilling contractor.

Our primary concern and one which we will make comment on today is that by eliminating these incentives, there will be a noticeable decrease in exploratory drilling activity and recoverable oil and gas reserves so critically needed for the security of this Nation.

We must assume the reason for the Treasury Department's proposal to remove the much-needed incentives from the industry was to bring more into line the balance of payments and to help correct the current Federal deficit.

An underlying premise of the Treasury Department's proposal is that the tax system should be neutral. That is, investments in one activity should not be favored vis-a-vis investments in another activity due to the tax consequences.

However, with respect to the energy provisions, Treasury has acknowledged that the intent is to disfavor new investments and to divert capital from the oil and gas exploration and production into other activity.

Thus, the energy-related proposals are inherently at conflict with a stated purpose of the proposals.

Unless and until the Treasury Department agrees that investment in oil and gas exploration and drilling should not be discouraged, it is unlikely that there will be a significant positive change made in any specific proposal to be considered in Washington.

For an investor from whom the dollars that the independents use and depend upon, the ability to expense two-thirds or more of his investment in oil and gas drilling during during the first year there is a major incentive for putting his dollars at risk.

Falling oil and natural gas prices during the past 2 years have already made it more difficult to raise that outside capital, through either debt or equity means.

If a worthwhile, yet high-risk investment, has no better tax treatment than a safe investment, the investor may as well play it safe.

Thus, we estimate that the third-party funding of oil and gas investment will all but disappear under the Treasury proposal.

Senator JOHNSTON. Say that again.

Mr. HARMON. We estimate that the third-party funding will all but disappear should the Treasury proposal or one of the other proposals be enacted.

Senator JOHNSTON. How much of your funding is third-party funding?

Mr. HARMON. We are talking about probably 32 percent of the total funding in our business, 32 percent of the available funds.

In January of this year LAIPRO conducted an extensive survey of more than 700 independent oil and gas operators in the State of Louisiana. Some of our findings were that if the Treasury proposal had been in effect in 1984, first, the capital available to independents for drilling would have been reduced by over 50 percent, although 32 percent is our historical level of outside investors; second; approximately 2,000 fewer oil and gas wells would have been drilled in the State of Louisiana alone; and third, no fewer than 210 independent producers in the State of Louisiana would have gone out of business or start putting their available dollars in other investments.

The aforementioned LAIPRO survey figures were backed by those issued by the Interstate Oil Compact Commission, which stated that more than 1 billion barrels of oil equivalent, oil and natural gas, will remain undiscovered and that more than 111,000 jobs would be lost in the State of Louisiana alone, out of some 630,000 nationwide.

Research has also shown that 50 jobs are lost for every $1 million reduction in drilling expenditures.

In Louisiana, for instance, our estimate is that drilling expenditures would drop $2.2 billion.

LAIPRO has carefully calculated that the average cost for an independent to drill an onshore Louisiana well, excluding the offshore, including the wetlands and north Louisiana, is in the neighborhood of $375,000 per well.

Under current law, using this average of $375,000 and assuming the life of the well is 10 years, the producer would have realized tax benefits of approximately $160,000 over the life of the well.

However, had the Treasury proposal been in effect, using that $375,000 figure, the same producer would have realized tax benefits of $85,000, which is a drop of some 50 percent in tax benefits.

Normally, oil and gas producers elect to expense IDC's in the year they are occurred, as this increases their after-tax cash flow. Because of the time value of money, a tax benefit allowed in year one is obviously worth more than the same tax benefit spread out over several years, affording the independent producer the immediate front-end cash flow which he needs to continue operating.

Using the same example just mentioned in lieu of the current law and considering the tax proposal being in effect, the producer is most severely hurt in the first year by at least 20 percent.

Although the producer's cash flow would be increased slightly more than 4 percent in the second year under this proposal, his tax benefits for new expenditures made in year two would once again be slightly less than 20 percent lower than under the current law.

So under the Treasury tax proposal, the after-tax cash flow of the producer who drills new wells each year would never catch up with the amount that he could expect to have under our existing law.

It has been estimated by several recent studies that there would be around 40 percent reduction in domestic exploration and development activity by independent oil and gas producers nationwide, and LAIPRO's survey indicates a similar effect on Louisiana.

Because independent producers in recent history have found in excess of 56 percent of the domestic oil and gas reserves, the diminishment of drilling activity by independents could reduce future reserves by about 25 percent

This limited reduction assumes the Treasury proposal would not affect or have the same adverse effect on the drilling activities of the major petroleum companies, due to the fact that the major companies do not rely as heavily on wellhead production to generate the cash necessary for drilling as do independents, and because the majors do not currently have the benefit of the percentage depletion.

The results of our survey and our study of repealing the depletion allowance, repealing the intangible drilling costs would have this effect in the time period of 1986 to 1991. These figures are conservative in our estimation, and the real impact would be much more.

First of all, drilling expenditures would be reduced by more than $2.2 billion in Louisiana alone.

As I mentioned, Louisiana would have a loss of more than 111,000 jobs from the industry. This includes other industries directly and indirectly affected by the industry.

Third, in excess of 2,000 wells would be—less than 2,000 wells would be drilled each year.

Another is that the active drilling rigs would decrease by more than 135 rigs per year.

Reserve additions would be reduced by more than 1 billion barrels of oil and gas equivalent during the 6-year time period.

Daily oil and gas production would fall by more than 150,000 barrels of oil equivalent.

Annual revenues from oil and gas sales would fall by more than $1 billion. That's using a figure, too, that we consider conservative, using the price of a 1950 equivalency.

State tax receipts from oil and gas production, the severance tax collected by the State of Louisiana, would fall in the range of $135 million, and that is pretty serious when you consider a State that's already in financial difficulty and considering the fact that every time a barrel of oil falls by $1 a barrel, the State is affected by at least $1 million.

It is a fact that the industry is currently facing a decline in drilling and production in the State of Louisiana, also. The various pending tax proposals would only serve to accelerate this decline.

Given this scenario, it would be only a few years before we would find ourselves back into the import dependency that we had in the early 1970's.

We are formalizing our study at this point. We will have it together by mid-April. We plan at that time to furnish it to all the committees of the Congress that will have an effect on the tax proposals, in addition to the entire Louisiana delegation. We'll make sure you get that by mid-April.

[The prepared statement of Mr. Harmon follows:]

LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS

STATEMENT BEFORE THE

U. S. SENATE ENERGY COMMITTEE

FRIDAY, MARCH 15, 1985
NEW ORLEANS, LOUISIANA

THANK YOU MR. CHAIRMAN. MY NAME IS WAYNE HARMON. I AM THE EXECUTIVE VICE PRESIDENT OF THE LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS (LAIPRO). WE ARE A LOUISIANA BASED TRADE ASSOCIATION, HEADQUARTERED IN BATON ROUGE, REPRESENTING THE VIEWS OF MORE THAN 1,500 INDEPENDENT OIL AND GAS PRODUCERS, GEOLOGISTS, ROYALTY OWNERS AND OTHERS WHO HAVE A SPECIFIC INTEREST IN THE INDEPENDENT OIL AND GAS BUSINESS IN THE STATE OF LOUISIANA.

TODAY ONE OF THE MOST CRITICAL ISSUES FACING THE STATE OF LOUISIANA, AND MORE SPECIFICALLY THE INDEPENDENT SECTOR OF THE OIL AND GAS INDUSTRY, IS THE POSSIBILITY OF SERIOUS CONSIDERATION, AND THE FEARED ADOPTION, OR PARTIAL ADOPTION OF THE UNITED STATES TREASURY DEPARTMENT'S TAX PROPOSAL (OR THE KEMP/KASTEN OR THE BRADLEY/GEPHARDT) NOW PENDING IN WASHINGTON. WE SINCERELY APPRECIATE THE EFFORTS AND TIME BY THE MEMBERS OF THE SENATE AND THE SENATE ENERGY COMMITTEE FOR ARRANGING THIS FIELD HEARING IN OUR STATE TO LISTEN TO THE VIEWS, PROBLEMS, AND SUGGESTIONS OF THE OIL AND GAS INDUSTRY.

LAIPRO HAS MANY LEGITIMATE CONCERNS AND OBJECTIONS TO THE PENDING PROPOSAL "THE TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH." IT IS INCONCEIVABLE TO US THAT IN TODAY'S EVER-CHANGING MARKETPLACE THAT THE U. S. TREASURY DEPARTMENT WOULD PROPOSE AND SUGGEST THE ELIMINATION OF CAPITAL GAINS, INVESTMENT TAX CREDITS, DEPLETION ALLOWANCE AND INTANGIBLE DRILLING COSTS. THESE ELIMINATIONS WOULD HAVE A SERIOUS AND DETRIMENTAL EFFECT ON FUTURE INVESTMENTS AND THE CASHFLOW AVAILABILITY IN THIS HIGH-RISK INDUSTRY. THE PROPOSAL WOULD VIRTUALLY ELIMINATE THE FUTURE ROLE OF THE INDEPENDENT OIL AND GAS OPERATOR AND DRILLING CONTRACTOR.

OUR PRIMARY CONCERN IN WHICH WE WILL MAKE COMMENT ON TODAY IS - THAT BY ELIMINATING THESE INCENTIVES THERE WILL BE A NOTICEABLE DECREASE IN EXPLORATORY DRILLING ACTIVITY AND RECOVERABLE OIL AND GAS RESERVES, SO CRITICALLY NEEDED FOR THE SECURITY OF THIS COUNTRY. WE MUST ASSUME THE REASON FOR THE TREASURY DEPARTMENT'S PROPOSAL TO REMOVE THE MUCH NEEDED INCENTIVES FROM THIS INDUSTRY IS TO BRING MORE INTO LINE THE BALANCE OF PAYMENT, AND, THEREFORE, REDUCE THE FEDERAL DEFICIT.

AN UNDERLYING PREMISE OF THE TREASURY PROPOSALS IS THAT THE TAX SYSTEM SHOULD BE NEUTRAL; THAT IS, INVESTMENT IN ONE ACTIVITY SHOULD NOT BE FAVORED VIS-A-VIS INVESTMENT IN ANOTHER ACTIVITY DUE TO THE TAX CONSEQUENCES. HOWEVER, WITH RESPECT TO THE ENERGY PROVISIONS, TREASURY HAS ACKNOWLEDGED THAT THE INTENT IS TO DISFAVOR NEW INVESTMENT AND DIVERT CAPITAL AWAY FROM OIL AND GAS EXPLORATION AND PRODUCTION INTO OTHER ACTIVITY.

THUS, THE ENERGY RELATED PROPOSALS ARE INHERENTLY AT CONFLICT WITH A STATED PURPOSE OF THE PROPOSALS. UNLESS AND UNTIL TREASRUY AGREES THAT INVESTMENT IN OIL AND GAS EXPLORATION AND DRILLING SHOULD NOT BE DISCOURAGED, IT IS UNLIKELY THAT ANY SIGNIFICANT POSITIVE CHANGE WILL BE MADE IN SPECIFIC PROPOSALS.

FOR AN INVESTOR, FROM WHOM THE DOLLARS INDEPEND PRODUCERS DEPENDS UPON, THE ABILITY TO EXPENSE TWO-THIRDS OR MORE OF HIS INVESTMENT IN OIL AND GAS DRILLING DURING THE FIRST YEAR IS A MAJOR INCENTIVE FOR PUTTING HIS DOLLARS AT RISK. FALLING OIL AND NATURAL GAS PRICES DURING THE PAST TWO YEARS HAVE ALREADY MADE IT MORE DIFFICULT TO RAISE OUTSIDE CAPITAL, THROUGH EITHER DEBT OR EQUITY MEANS. IF A WORTHWHILE YET HIGH RISK INVESTMENT HAS NO BETTER TAX TREATMENT THAN A SAFE INVESTMENT, THE INVESTOR MAY AS WELL PLAY IT SAFE. THUS, WE ESTIMATE THAT THIRD PARTY FUNDING WILL ALL BUT DISAPPEAR UNDER THE TREASURY PROPOSAL.

IN JANUARY OF THIS YEAR, LAIPRO CONDUCTED AN EXTENSIVE SURVEY OF MORE THAN 700 INDEPENDENT OIL AND GAS PRODUCERS IN LOUISIANA. SOME OF OUR FINDINGS WERE THAT IF THE TREASURY PROPOSAL WERE IN EFFECT IN 1984:

- THE CAPITAL AVAILABLE TO INDEPENDENTS FOR DRILLING WOULD HAVE BEEN REDUCED BY OVER FIFTY PERCENT (VIRTUALLY ALL OUTSIDE VENTURE CAPITAL WOULD HAVE DISAPPEARED ALONG WITH ABOUT ONE-THIRD OF INTERNALLY GENERATED CAPITAL).

- APPROXIMATELY 2,000 FEWER OIL AND NATURAL GAS WELLS WOULD HAVE BEEN DRILLED IN LOUISIANA ALONE, AND

- NO FEWER THAN 210 LOUISIANA INDEPENDENTS WOULD EITHER HAVE GONE OUT OF BUSINESS OR WOULD HAVE PUT THOSE AVAILABLE DOLLARS IN SAFER INVESTMENTS.

THE AFOREMENTIONED LAIPRO SURVEY FIGURES WERE BACKED UP BY THOSE ISSUED BY THE INTERSTATE OIL COMPACT COMMISSION, WHICH STATED THAT MORE THAN 1 BILLION BARRELS OF OIL EQUIVALENT (OIL AND NATURAL GAS) WILL REMAIN UNDISCOVERED AND MORE THAN 111,000 JOBS WOULD BE LOST IN THE STATE OF LOUISIANA ALONE (OUT OF 630,000 NATIONWIDE) FOR THE 1986 - 1991 TIMEFRAME. RESEARCH HAS SHOWN THAT FIFTY JOBS ARE LOST FOR EVERY ONE MILLION DOLLAR REDUCTION IN DRILLING EXPENDITURES.

LAIPRO HAS CAREFULLY CALCULATED THAT THE AVERAGE COST FOR AN INDEPENDENT TO DRILL AN ONSHORE LOUISIANA WELL (EXCLUDING OFFSHORE) IS APPROXIMATELY $375,000. UNDER CURRENT LAW USING THE AVERAGE $375,000 WELL COST FIGURE (AND ASSUMING THE LIFE OF THE WELL IS TEN YEARS) THE PRODUCER WOULD HAVE REALIZED TAX BENEFITS OF APPROXIMATELY $160,000 OVER THE LIFE OF THE WELL. HOWEVER, WERE THE TREASURY TAX PROPOSAL IN EFFECT, THAT SAME PRODUCER WOULD HAVE REALIZED TAX BENEFITS OF $85,000 OVER THE LIFE OF THE WELL INDICATING AN ALMOST 50% DROP IN TAX BENEFITS. NORMALLY, OIL AND GAS PRODUCERS ELECT TO EXPENSE IDC'S IN THE YEAR OCCURRED, AS THIS INCREASES THEIR AFTER-TAX CASH FLOW. BECAUSE OF THE TIME VALUE OF MONEY, A TAX BENEFIT ALLOWED IN YEAR ONE IS OBVIOUSLY WORTH MORE THAN THE SAME TAX BENEFIT SPREAD OUT OVER SEVERAL YEARS, AFFORDING THE PRODUCER AN IMMEDIATE FRONT-END CASH-FLOW WHICH HE NEEDS TO CONTINUE OPERATING.

USING THE SAME EXAMPLE JUST STATED AND IN LIEU OF CURRENT LAW AND AGAIN SUBSTITUTING THE TREASURY PROPOSED CHANGES, THE PRODUCER IS MOST SEVERELY HURT IN THE FIRST YEAR BY AT LEAST 20 PERCENT. ALTHOUGH THE PRODUCER'S CASH FLOW WOULD BE INCREASED BY SLIGHTLY MORE THAN FOUR PERCENT IN THE SECOND YEAR UNDER THIS PROPOSALS, HIS TAX BENEFITS FOR NEW EXPENDITURE MADE IN YEAR TWO WOULD ONCE AGAIN BE SLIGHTLY LESS THAN 20 PERCENT LOWER THAN UNDER THE CURRENT LAW. SO, UNDER THE TREASURY PROPOSAL, THE AFTER-TAX CASHFLOW OF THE PRODUCER WHO DRILLS NEW WELLS EACH YEAR WOULD NEVER CATCH UP WITH THE AMOUNT HE COULD EXPECT TO HAVE UNDER EXISTING LAW.

IT HAS BEEN ESTIMATED BY SEVERAL RECENT STUDIES THAT THERE WOULD BE AN ESTIMATED 30 TO 50 PERCENT REDUCTION IN DOMESTIC EXPLORATION AND DEVELOPMENT ACTIVITY BY INDEPENDENT OIL AND GAS PRODUCERS NATIONWIDE AND LAIPRO'S OWN SURVEY INDICATES A SIMILAR EFFECT ON LOUISIANA. BECAUSE INDEPENDENT PRODUCERS IN RECENT HISTORY HAVE FOUND IN EXCESS OF 56 PERCENT OF NEW DOMESTIC OIL AND GAS RESERVES, THE DIMINISHMENT OF DRILLING ACTIVITY BY INDEPENDENTS COULD REDUCE FUTURE RESERVES BY 20 TO 28 PERCENT. THIS LIMITED REDUCTION ASSUMES THAT THE TREASURY PROPOSAL WILL NOT HAVE AN ADVERSE IMPACT ON THE DRILLING ACTIVITIES OF THE MAJOR PETROLEUM FIRMS. DUE TO THE FACT THAT THE MAJOR OIL COMPANIES DO NOT RELY AS HEAVILY ON WELLHEAD PRODUCTION TO GENERATE THE CASH NECESSARY FOR DRILLING, AND BECAUSE THE MAJORS DO NOT CURRENTLY HAVE THE BENEFIT OF THE PERCENTAGE DEPLETION, THE IMPACT OF THE TREASURY PROPOSAL ON THE MAJOR OIL COMPANIES DRILLING ACTIVITY IS CONSIDERABLY LESS THAN THE IMPACT ON THE INDEPENDENT SECTOR OF THIS INDUSTRY.

... THE RESULTS OF OUR STUDY OF REPEALING THE EXPENSING OF INTANGIBLE DRILLING COSTS AND PERCENTAGE DEPLETION, WOULD HAVE THE FOLLOWING AVERAGE RESULTS, DURING THE 1986-91 TIME PERIOD:

o DRILLING EXPENDITURES WOULD BE REDUCED BY MORE THAN $2.2 BILLION DOLLARS IN LOUISIANA.

o LOUISIANA WOULD HAVE A LOSS OF MORE THAN 111,000 JOBS FROM THE INDUSTRY

o IN EXCESS OF 2,000 WELLS WOULD NOT BE DRILLED EACH YEAR.

o ACTIVE DRILLING RIGS WOULD DECREASE BY MORE THAN 135 YEARLY.

o RESERVE ADDITIONS WOULD BE REDUCED BY MORE THAN 1 BILLION BARRELS OF OIL AND GAS EQUIVALENT DURING THE SIX YEAR TIME PERIOD.

o DAILY OIL AND NATURAL GAS PRODUCTION WOULD FALL BY MORE THAN 150 THOUSAND BARRELS OF OIL EQUIVALENT.

o ANNUAL REVENUES FROM OIL AND GAS SALES WOULD FALL BY MORE THAN ONE BILLION DOLLARS.

o STATE TAX RECEIPTS FROM OIL AND GAS PRODUCTION (SEVERANCE TAX) WOULD FALL BY $135 MILLION DOLLARS.

IT IS A FACT THAT THE INDUSTRY IS CURRENTLY FACING A DECLINE IN DRILLING AND PRODUCTION. THE VARIOUS PENDING TAX PROPOSALS WOULD ONLY SERVE TO ACCELERATE THIS DECLINE. GIVEN THIS SCENARIO, IT WOULD ONLY BE A FEW YEARS BEFORE WE WOULD FIND OURSELVES RIGHT BACK TO OUR IMPORT DEPENDENCE OF THE 1970'S.

MR. CHAIRMAN, WE ARE IN THE PROCESS OF FORMALIZING OUR STUDY AND SURVEY RESULTS ON THE DEVASTATING IMPACT OF THE REPEALMENT OF THE EXPENSING OF IDC, PERCENTAGE DEPLETION (AND ITS IMPACT ON STRIPPER PRODUCTION), EXPENSING OF QUALIFIED TERTIARY EXPENSES, ACRS AND OTHERS. THIS STUDY WILL BE COMPLETED BY MID-APRIL AND FURNISHED TO ALL MEMBERS OF THE LOUISIANA CONGRESSIONAL DELEGATION AS WELL AS YOUR COMMITTEE.

SHOULD YOU HAVE ANY QUESTIONS, WE WILL BE HAPPY TO ELABORATE ON THEM.

CAPSULE DESCRIPTION OF TREASURY DEPARTMENT TAX REFORM PROPOSALS

MOST IMPORTANT TO INDEPENDENT OIL AND GAS PRODUCERS

1. Percentage depletion repealed, effective 1/1/86 for existing and future production.

2. Expensing of intangible drilling costs (IDC) repealed, effective 1/1/86.

In place of percentage depletion and current expensing of IDC there would be a system of "cost depletion." The term "cost depletion" is misleading as there is no recognition of the exhausting of a non-renewable capital resource. Rather, it amounts to amortization of intangible expenditures attributable to a property over the producing life of the property. The basis in the property would be indexed for inflation.

3. Dry hole costs could be written off only at the time a property is abandoned. The cost of dry holes drilled on leases retained for further exploration, or development drilling, would have to be carried forward until such time as there is production from the property, in which event dry hole costs would be included in the "cost depletion" computation, or until the property is abandoned without production. Effective 1/1/86.

4. Expensing of qualified tertiary injectant expenses repealed, effective 1/1/86.

5. Investment Tax Credit (ITC) repealed, effective 1/1/86.

6. Accelerated Cost Recovery System (ACRS) repealed, effective 1/1/86.

In place of ITC and ACRS would be depreciation over economic life of assets with basis indexed for inflation. Most petroleum industry equipment now treated as tangible expenditures would be amortized over 15 years.

7. "At-Risk" rules retained and applied to all investments.

8. Partnerships with 35 or more limited partners would be taxed as corporations. So-called "S" corporations, limited partnerships with 35 or fewer limited partners and general partnerships will continue to be accorded pass through treatment. Affected partnerships already in existance prior to 1985, would not become subject to this until 1/1/90.

9. Retain individual alternative minimum tax and corporate minimum tax until 1/1/90.

10. Restrict the use of the cash method of accounting to businesses that do not use the accrual method for financial accounting purposes, carry no inventories, and have annual gross receipts of less than $5 million.

11. To assure uniform treatment of all multiperiod production activities (i.e., oil and gas production), develop comprehensive rules for capitalization of indirect costs such as interest and delay rental payments.

12. Phase-out the Windfall Profit Tax over 33 months commencing 1/1/88.

13. Corporations could deduct from taxable income one-half of dividends if paid from income subject to tax, but not dividends paid from income that had not been subject to corporate tax. To be phased in over a period of several years.

LAIPRO 3/11/85

Senator **Johnston**. Thank you very much, Mr. Harmon. You have 700 members, do you, 700-plus members?

Mr. **Harmon**. We have 1,500 members. On our survey we surveyed 700 producers and operators in the State of Louisiana.

We've got members outside the State that operate in Louisiana, but we tried to use independent producers in the State.

Senator **Johnston**. I see. That is a real public service, Mr. Harmon, to have made that survey. I'm glad we could get the results of it here. I especially want to see the published survey when it's available, next month you say?

Mr. **Harmon**. Yes.

Senator **Johnston**. That will be very helpful to us.

Senator Long, do you have any questions?

Senator **Long**. Thank you very much. It's a very well-considered statement, Mr. Harmon, very well-documented and well-supported statement. I appreciate it.

Mr. **Harmon**. Robert, would you like to make a sensational statement?

STATEMENT OF ROBERT F. MEREDITH III, HOGAN EXPLORATION, COLUMBIA, LA

Mr. **Meredith**. Thank you very much, Senator Long and Senator Johnston. My remarks will be very brief. I do not have a prepared statement.

I will point out that I think most of the people who have spoken here so far today and probably most of the ones afterwards are looking at the entire industry.

I'm kind of down on the far end, because I am about as independent as they come. I represent not only an exploration company with approximately 15 employees, a very small company, but also I have a small drilling company, with small rigs for drilling to shallow depths; it employs approximately 35.

With that 50 employees, we rank, if you could believe it, as the second largest employer in Caldwell Parish. We are obviously a very rural area.

What has happened to us, to the industry, in the last 3 years, since the oversupply of oil and gas has developed, is that the number of active drilling rigs in the continental United States, has fallen from a high of approximately 4,500 in December 1981, to approximately 2,100 in the latest count. We now have less than half the number of rigs working than we had just a little more than 3 years ago.

Senator **Johnston**. Do you drill for oil or gas?

Mr. **Meredith**. Well, for both. Most of our production is in gas, but we are active in both. We are in what's called the well criteria.

Senator **Johnston**. You do deep drilling or shallow?

Mr. **Meredith**. Shallow drilling, which is where you will find most of the independents are for cost reasons.

Senator **Johnston**. How much of your money comes from outside money?

Mr. **Meredith**. At least two-thirds. I think Wayne pointed out approximately 32 percent of funds come from outside, an average, for the industry. When you get down to the level of companies the size of ours, it's much more than that. The lower you go on the scale, you'll find the more outside money that's put into it.

I would estimate at least two-thirds of our exploratory capital is outside money.

Senator JOHNSTON. Wayne Harmon said that 32 percent came from outside in the industry as a whole, and that that would virtually dry up. Would you expect to get that, or would that dry up, and why would you say that?

Mr. MEREDITH. I would expect it to virtually completely dry up, because we have seen it—it's almost dry right now just from the drop in oil prices, drop in gas prices, particularly on the gas market there's even a problem of being able to sustain takes to the pipelines.

With those things in mind, outside capital is already extremely difficult. I would say that is the primary reason—the primary problem that's facing the independent industry today is the problem with raising outside capital. With the problems that we have already, it is a very, very difficult problem, and if this so-called simplification plan is passed, it will virtually kill all of us.

Senator JOHNSTON. The intangible drilling expense deduction where they can deduct the whole cost of a dry hole in the first year, that is a major factor, is it, with your investors?

Mr. MEREDITH. Absolutely, and without it I suspect that we wouldn't raise 10 percent of the capital that we raise.

Senator JOHNSTON. Now, as I understand this Treasury proposal, they repeal expensing of intangibles, but provide that you deduct the cost of the well as a depreciation factor over a period of years, and you can begin that only when you abandon the field.

Most of the places you've drilled, are they wildcat wells or are they development wells?

Mr. MEREDITH. Well, we drill lots of both. In many cases we will spend several years finding something. We may drill one well this year and we may have a 5-year lease, and we may drill another one next year. It may be the third or fourth year before we find it.

The nature of our particular business is that it takes a lot of wells to find reserves, and when you stretch it out, you are spending dollars for 3 or 4 years before you even find anything to generate any income with.

Senator JOHNSTON. Most of your leases are 5-year leases?

Mr. MEREDITH. Well, that's a common term, and 3 years is a common term. They are usually in that range.

Senator JOHNSTON. Senator Long.

Senator LONG. You have to put it in a sentence, the simplification bill would simplify a great number of independents out of business, wouldn't it?

Mr. MEREDITH. It would simplify our business greatly, because instead of employing approximately 50 people, we would probably employ about 8.

Senator LONG. And for a lot of independents, it would simplify them right out of business completely, wouldn't it?

Mr. MEREDITH. Absolutely, and the effects on the drilling industry and the services connected with the drilling industry, of course, are where the great employment aspect of this situation occurs. The first thing I'm going to do if this passes, I'm going to look to sell the drilling rig, if I can sell it, which I doubt. There's just no way. Drilling rigs right now are stacking left and right.

Senator **Johnston**. Thank you very much, Mr. Meredith. You've been very helpful. I understand, by the way, that you are John McKeithen's nephew. Please give the Governor our regards.

Mr. **Meredith**. Thank you very much.

Senator **Johnston**. Next I want to welcome Ms. Ginger Sawyer, who is with the Louisiana Association of Business and Industry, known as LABI.

Ginger, we are very glad to have you here, and we appreciate the good work you've done. I know you've been making a survey, too.

STATEMENT OF GINGER SAWYER, LOUISIANA ASSOCIATION OF BUSINESS AND INDUSTRY

Ms. **Sawyer**. Thank you, Senator Johnston and Senator Long.

I appreciate the opportunity to make this statement on behalf of LABI today. I am in somewhat a different situation than those who have spoken before me in that as the energy council director for LABI and also the director of Grass Roots and National Affairs, I take a slightly different charge when I'm asked to discuss the energy impacts of a piece of legislation such as this.

The energy council of LABI is not only the producing sector, but also the transportation sector, the utilities and the consuming industries. So I will use that approach, if you don't mind, in my remarks.

The major purpose of LABI, as is the purpose of the Congress, is healthy economic growth for the State and for the Nation.

One of the problems that is seen is that we seem to be forgetting that the goal of tax simplification should be economic growth. While the reform proposals may enhance economic growth in some areas or States, we don't see that that is the case in Louisiana.

It could be devastating to Louisiana's current economy and also to the potential economic bases.

The various proposals seem to rest on an absurd premise that the tax law does not affect economic decisionmaking and hence economic activity.

The Treasury Department's tax reform proposal is disappointing because it reverses many of the wise policies enacted in 1981. It also shifts the tax burden away from consumption toward production, a dubious move in terms of economic growth.

It is estimated that during the first 5 years of the Treasury's plan, aggregate corporate income tax liabilities could jump by at least 25 percent, and in some years would move up by a third or more.

Over 1986 through 1990, the Government's take from corporate taxes would rise by some $165 billion. Not surprisingly, taxes paid by individuals would fall by about the same amount.

Compared to current law, the Treasury tax plan can be estimated to result in a falloff in fixed income, but would result in slightly stronger consumer spending because of the reduced individual income tax effective rates.

The impact, however, of the reduced capital formation and the lower ration of capital to labor can be expected to diminish the economy's future growth prospects.

As far as the oil and gas issues specifically, the effects on exploration and production, I think, were very well handled by Secretary Porter and Mr. Harmon. I would like to reiterate a couple of our specific concerns.

We are concerned about reserves. We are concerned about the effect on exploration and production. We are very concerned about the dependence on foreign imports and what the reduction of exploration and production could have on foreign imports.

We are also concerned about premature abandoning of marginal properties and the effect on enhanced recovery techniques.

I recall that during 1984 regular session of the Louisiana Legislature, we allowed a tax incentive for those companies that were involved in tertiary recovery projects, but this is going to have just the opposite effect on CO_2 and other tertiary projects.

This is the fourth straight year, 1985, of decline in capital for exploration and production in the United States. Compared with the peak spending year of 1981, 1985 will be down 40 percent already without any additional tax burdens, or the effects of this tax proposal.

We are also concerned in that we are very supportive of offshore drilling. We are very supportive of revenue sharing and the other OCS issues, and we feel that this would have a devastating effect on OCS exploration, particularly in that OCS exploration costs generally, depending on whether it's oil or gas specifically, five to ten times the national average production costs.

An area that I don't believe will be discussed by any of the people who will follow me is the impact of ITC and ACRS on capital-intensive industry. I'm going to speak from the consuming side on this so that we hit the energy-intensive industries.

We'll discuss this in light of refining, of petrochemical companies and forestry or those others who have their heavily capital-intensive base such as cogeneration, general retrofitting of facilities, automation, revamping, energy conservation, expansion, new product lines, retrofitting, construction.

It's estimated that in 1985, 60 percent of the petrochemical outlay in the country will be in new product development, and this tax proposal will have a direct bearing on that.

For capital-intensive industries, the investment program is one of the most important aspects. Approximately one-third of a year's capital program is in maintenance capital, keeping equipment in good shape, retrofitting, replacement, efficiency, keeping equipment in harmony with technological advancements, better labor/material utilization.

Another 10 percent goes into safety and environmental regulations and laws; improvements mandated by the industry or mandated by Federal or State agencies; to meet the legal and moral obligatons.

We also have many people who anticipate a regulatory response to such incidents as Bhopal, or what could happen with the additional expenditures involving Superfund.

The remaining 50 to 60 percent is invested in expansion, expanded existing capacity and then also in new product lines.

The importance of ACRS to these capital-intensive industries is to be able to rapidly write down the cost of the investment. There is such a swift pace in the change of technology that it is important for these technologically advancing industries to be able to write off their costs as quickly as possible.

They would like to get it off the books in 5 or 6 years, because there isn't as profitable a life in these high-tech industries as there is perhaps in others. They keep the old technology, but it's just not as profitable.

For a long time the U.S. chemical industry was shielded from the rest of the world, but now that it's in the global market we obviously must participate in that.

Quickly hit by overseas competition, these companies in the United States, the domestic companies, must respond to additional technology advances so that they can keep pace. They need the capital incentives. They need the research and development incentives so that they can move on.

For the first time, American companies have had a capital cost recovery system that was not inferior to those available to most of our foreign-based industrial competitiors.

Retreating from this sound policy will make it harder for U.S. companies to compete in world markets, leading to lower exports, high imports and a further worsening of our trade deficit.

In the real world our basic industries have to compete against companies based in countries whose tax systems provide generous capital recovery allowances. You might note that Canada has recently revamped its national energy program to encourage investment, while we at the same time are looking at doing the reverse.

ACRS's value has already been reduced from the level it was in 1981 with the program through revisions in 1982 and 1984. So we are just moving further away from what was done in 1981.

Only adequate capital cost recovery allowances allow the economy to grow as quickly as would be possible under an unfettered free market. The Treasury proposal constitutes a reversal of the progrowth policies inaugurated.

Treasury estimates over the period 1986 to 1989 elimination of the ITC will increase Federal tax revenues by $147 billion, while the substitution of RCRS for ACRS will add another $213 billion. That means an awful lot of companies will have a lot less money to invest in modernized plant and equipment.

It is difficult to understand how the Treasury can be so sanguine about the economic effects of abruptly removing some $360 billion in capital formation incentives.

Another industry that needs to be included in capital intensive is the electric utility industry. It is faced with the same problems of ITC and ACRS.

In this period of large construction programs, it is becoming increasingly difficult for the utilities and their customers to survive financially.

In that AFUDC results in large amount of imputed income which is not realized as cash return, the ACRS needs to maintain its longer depreciation period for utility property.

The savings due to ITC and ACRS inure to the benefit of the utilities' customers.

I might mention briefly, we would like to maintain energy tax credits. They are due to expire at the end of 1985; under the FAIR and FAST proposals, they would be repealed. These credits have proven very beneficial to Louisiana's energy-intensive industry, as well as commercial and residential taxpayers, and they should be extended.

In an attempt to protect themselves from rate shock, taxpayers have been able to receive the credits, and should continue to receive them in order to reduce consumption. It is an incentive that is in the Nation's best interest in terms of conservation.

I don't want to discriminate at all between capital and labor-intensive industry. I don't want to penalize labor-intensive industry in business. They are needed. They are needed to provide an orderly transition into this new industrial base that we all keep talking about.

In the meantime, we need to protect those industries that we do have that have for so long been the backbone of the Louisiana economy. We need to provide the transition into the small business area, the areas that do create the jobs.

But if you are going to move into a labor-intensive industry system in Louisiana, ITC and ACRS will still impact, even though not as great as the capital-intensive industry, but since we don't have it now, we have to build those structures. We have to provide that equipment, and these benefits will still go to to the labor-intensive industry.

Any of the new facilities would qualify for the incentives presently offered, and even though they are not as costly as capital-intensive, they still would discourage labor- intensive industry to build this new base.

The chief tax counsel for Chrysler Corp. put his finger on the problem of labor-intensive industry. He said, "We have a major concern that Congress will go after the accelerated cost recovery system and the investment tax credit." This is labor-intensive industry. "That would affect what we do several years from now."

Well, it's affecting what we in Louisiana are going to do several years from now.

Modifications of the tax credits for incremental research and development should also be closely examined. In that much of the labor-intensive industry that Louisiana is seeking to attract will depend on heavy expenditure of R&D funds, these credits are truly an incentive that will benefit industries based on new technologies.

Tax reform could dramatically increase economic efficiency and spark unequaled economic growth. But all tax reform proposals are not created equal and some are clearly better than others.

The wrong kind of tax reform, in particular a tax system which shifts the burden to the corporate sector, as many of them do, could have very serious long-term effects on the Louisiana and the national economy.

That concludes my statement and I would be pleased to answer any questions.

[The prepared statement of Ms. Sawyer follows:]

Statement for Field Hearing--Treasury Tax Proposal--March 15, 1985

"The Tax Reform for Fairness, Simplicity and Economic Growth"

I. Appreciate opportunity to make statement on behalf of LABI, representing the Louisiana business community. One of the major problems seen is that we seem to be forgetting that the goal of tax reform should be to enhance economic growth. While the reform proposals may enhance economic growth in some regions or states, it appears that the proposals stand to devastate Louisiana's current and potential economic bases.

The various proposals rest on the "absurd premise that the tax law does not affect economic decision-making, and hence, economic activity."

The Treasury Department's tax reform proposal is disappointing because it reverses many of the wise policies enacted in 1981. It also shifts the tax burden away from consumers towards producers--a dubious move in terms of economic growth.

Over the first five years of the Treasury's plan, aggregate corporate income tax liabilities would jump by at least 25 percent and in some years would go up by a third or more. Over 1986-1990, the government's take from corporate taxes would rise by some $165 billion. Not surprisingly, taxes paid by individuals would fall by about the same amount.

Compared to current law, the Treasury tax plan can be expected to result in a falloff in fixed investment, but slightly stronger consumer spending because of the reduced individual income tax rates and increased after-tax income. The impact, however, of the reduced capital formation and the lower ratio of capital to labor can be expected to diminish the economy's future growth prospects.

II. Oil and gas issues: LAIPRO and Mid-Continent handled well.

A. Concern about reserves: merger trend for reserves--no drilling, reduced reserves, dependence on foreign imports.

B. Premature abandoing of marginal properties as uneconomical.

C. Effect on enhanced recovery techniques--very important in Louisiana--CO2, injection, tertiary recovery exemption passed by Legislature.

D. It will be the fourth straight year of petroleum industry capital and exploration budget declines--compared with the peak spending year of 1981, this year's outlay will be down 40%.

E. Effect on deep-water drilling--very expensive. OCS cost is five to ten times the national average.

III. Impact of ITC and ACRS on capital-intensive industry

A. Cogeneration

B. General retrofitting; automation; revamping

C. Energy: conservation retrofitting

D. Expansions

E. New product lines: retrofit/construct; 60% petrochemical outlay in specific product development/production in 1985.

F. For capital intensive industries the investment program is one of the most important aspects. Approximately 1/3 of a year's capital program is in "maintenance capital"--keeping equipment in good shape, retrofitting; replacement; efficiency; keeping equipment in harmony with technological advancements; better labor/material utilization. Another 10% goes into safety and environmental improvements: correct and upgrade to meet laws and regulations; moral and legal obligations. Substitutes for gasoline additives--in response to requirement that lead content be reduced. Regulatory response to the fatal leak in Bhopal may result in investments in required monitoring, containment or protective equipment. Superfund expenses. The remaining 50-60% is invested in expansion: (1) existing: expanding capacity; (2) new: new product lines for company; in some cases domestic production replacing foreign production if demand is there.

G. Importance of ACRS: Rapid write down of cost is particularly good for the chemical industry; there is a swift pace of change--not a long-term benefit in new technology. Would like it off books in five to six years; not as long a profitable life; keep technology instead of replacing, but not as profitable. For a long time, the U.S.

chemical industry was shielded from the rest of the world—now a global market. Quickly hit by overseas competition as they get technology. Need capital incentives, R&D, to keep ahead.

For the first time, American companies have had a capital cost recovery system that was not inferior to those available to most of our foreign-based industrial competitors. Retreating from this sound policy will make it harder for U. S. companies to compete in world markets, leading to lower exports, high imports and a further worsening of our trade deficit.

In the real world, our basic industries have to compete against companies based in countries whose tax systems provide generous capital recovery allowances. Note that Canada has recently revamped its national energy program to encourage investment--while we are looking at doing the reverse.

ACRS' value has already been reduced from the level of 1981, through the 1982 and 1984 revisions.

Only adequate capital cost recovery allowances allow the economy to grow as quickly as would be possible under an unfettered free market. The Treasury proposal constitutes a reversal of the pro-growth policies inaugurated in 1981.

Treasury estimates that, over the period of 1986-1989, elimination of the ITC will increase federal tax reenues by $147 billion, while the substitution of RCRS for ACRS will add another $213 billion. That means an awful lot of companies will have a lot less money to invest in modernized plant and equipment. It is difficult to understand how Treasury can be so sanguine about the economic effects of abruptly removing some $360 billion in capital formation incentives.

Another industry that needs to be included in "capital intensive" is the electric utility industry--it is faced with the same problems of ITC and ACRS. In this period of large construction programs, it is becoming increasingly difficult for the utilities and their customers to survive financially. In that AFUDC results in large amounts of "imputed" income which is not realized as a cash return, the ACRS needs to maintain its longer depreciation period for utility property. The savings due to ITC and ACRS enure to the benefit to the utilities' customers.

IV. Energy Tax Credit

The current energy investment tax credits of 15% will expire at the end of 1985. Under the treasury plan, they would be allowed to expire. Under the FAIR and FAST proposals, they would be repealed. These credits have proven very beneficial to Louisiana's energy-intensive industry, as well as commercial and residential taxpayers, and they should be extended. In an attempt to protect themselves from "rate shock," these taxpayers have been able to receive the credits, and should continue to receive these credits, in order to reduce consumption. It is an incentive that is in the nation's best interest in terms of conservation.

V. Discrimination between capital and labor-intensive industry

A. Don't penalize labor-intensive industry and business; need to provide orderly transition into a new industrial base. Don't discourage the transition--small business. Capital-intensive industry, however must be kept whole until the transition is made.

The impact of repealing or changing ACRS and ITC will not only affect capital-intensive industry in La. It will also discourage the coversion to labor-intensive industry. Any new facilities and equipment would qualify for the incentives; and, while not being as costly as some capital-intensive facilities, any changes would discourage the labor-intensive construction to build a new, sound economic base.

The chief tax counsel for Chrysler Corporation put his finger on the problem for labor-intensive industry--"We have a major concern that Congress will go after the accelerated cost recovery system and the investment tax credit. That would affect what we do several years from now." It would be the same for labor-intensive industry in Louisiana, and would be a deterrent to the direction Louisiana needs to take.

The modifications of tax credits for incremental research and development should also be closely examined. In that much of the labor-intensive industry that Louisiana is seeking to attract will depend on heavy expenditure of R&D funds, these tax credits are truly an incentive that will benefit industries based on new technologies.

B. The reduced rate at which mortgage interest is deductible in the alternate versions will hurt the housing market--depressed in many Louisiana areas. Home values can be expected to decline and limit both the demand for and supply of new homes. All current owners will take a capital loss, limiting their ability to stretch for a larger and more expensive home. Builders; profit margins will be squeezed with the lower proces, and the supply of new homes will be reduced.

C. Opposition also comes from state and local governments that assess or wish to assess higher per-capita taxes on their citizens; charities, particularly those that rely heavily on gifts of appreciated property; and labor unions that have negotiated high levels of tax-free benefits for their members.

VI. Conclusion

Tax reform could dramatically increase economic efficiency and spark unequaled economic growth. But all tax reform proposals are not created equal and some are clearly better than others. The wrong kind of tax reform, in particular a tax system which shifts the burden to the corporate sector, as many of them do, could have very serious long run effects on the U. S. and Louisiana economy.

Senator JOHNSTON. Thank you very much, Ms. Sawyer, for an excellent statement. Your are doing excellent work at LABI and being very helpful to us in our work.

Senator Long, did you have any questions?

Senator LONG. No. I enjoyed the statement. Thank you very much.

Senator JOHNSTON. Thank you very much, Ms. Sawyer.

Next we are happy to welcome Mr. Jim Terrill, president and chief operating officer of Louisiana Intrastate Gas Corp. from Lafayette.

Jim has frequently testified before us in Washington, and we are happy to welcome you here.

STATEMENT OF JAMES L. TERRILL, PRESIDENT AND CHIEF OPERATING OFFICER, LOUISIANA INTRASTATE GAS CORP., LAFAYETTE, LA

Mr. TERRILL. Thank you very much. I am delighted to be here.

I wear several hats, as you may know, and I would like first to bring a perspective from a consumer transporter, or the middle man perhaps in this trilogy of events that move natural gas from the well ultimately to the consumer.

We own and operate both an intrastate and an interstate pipeline, as you know. We have the most extensive intrastate pipeline in Louisiana.

We estimate that we serve in excess of 1 million homeowners and small commercial users indirectly through the industrial sales that we make to power consumption and then to citygate stations, who ultimately distribute gas to the homeowner.

By definition, the intrastate pipeline traditionally has received most of its gas from instate sources. Eighty percent, at least, of our gas supplies in the most recent years have come from the independent producer, and the independents nationwide indicate they drill 89 percent of the wildcats, 86 percent of all wells, and they control 56 percent of all the reserves.

It's this group that we're concerned about with respect to the pipeline side of things and the adverse effect that it will have on the drilling and completion activity within our State.

This comes at a time when it could ill be absorbed by the independent, because he is seeing, as Mr. Meredith testified earlier, particularly in natural gas, a decline in not only price, which we might be able to absorb for a few years as producers; but he's seeing a substantial decline in the volume of gas that he sells in proportion to that which he has available to sell.

So he's taking a double dip in his cash flow. Cash flow to an independent is vital, as was testified to earlier, and I don't need to reiterate that. That current cash flow is vital to his needs.

The Canadian situation is further causing producers in the United States to share the market that exists, and this could perhaps go on for a few more years before we see some relief from that.

This comes at a time when the trade journal, the Oil and Gas Journal, reports in its most recent week's publication that the Ark-La-Tex could be in for a new era of activity, and it's generated by a north Louisiana play that is developing along the Arkansas-Texas-Louisiana borders. Deeper drilling——

Senator JOHNSTON. That's a gas play?

Mr. TERRILL. It's gas and oil, Senator. It's Jurassic and deeper, Paleozoic play.

Senator JOHNSTON. How deep is that?

Mr. TERRILL. There is a 16,000-foot well going in north Louisiana in Union Parish now being drilled by Amoco.

These wells will require substantial capital and substantial risk. They are wildcat wells, but it's the kind of activity that we are going to require for the future if we must remain self-sufficient.

It comes at a time when it's going to be very discouraging to do it with these kinds of tax proposal changes.

Let me say just a word about our own——

Senator LONG. Could I ask just one question with that?

Mr. TERRILL. Yes, sir.

Senator LONG. Have you found some gas in various sand at or about that depth to encourage you to think that these wells will be successful?

Mr. TERRILL. Yes. Jurassic production is a known producer in those areas, but it is becoming more so—the search is becoming more so now.

If you remember, Black Lake Field in north Louisiana was the most significant onshore reserve found by Placid Oil Co. in a decade some years ago.

It was a petit formation and there were wildcat wells that had been drilled within a mile or two of that field as it was later found; and this is the kind of effort that is now being made in north Louisiana that historically had been south Louisiana type exploration activity!

The dollars are being recommitted back to that area of the State; it has been neglected for these many years.

Celeron Oil & Gas, an affiliate of ours, is a substantial producer and explorer of gas. We were ranked 36th largest independent in a survey recently published by the Oil and Gas Journal.

We spent approximately $100 million this year in exploration efforts of our own. My chairman has authorized me to say that that likely would be 20 million or less compared to 100 million were these tax proposals in effect at the current time.

Senator **Long**. Let me get this straight. Are you saying that the 100 million would be reduced by 20 million or that it would be reduced to 20 million?

Mr. **Terrill**. It would be reduced by 80 million to 20 million.

Senator **Long**. So 80 percent of that activity would be cut out?

Mr. **Terrill**. That's correct.

Senator **Johnston**. That's of the wildcat activity?

Mr. **Terrill**. The 20 million would be mostly development wells. That's why we would spend that money.

Senator **Johnston**. So what you are saying is wildcat drilling would virtually cease?

Mr. **Terrill**. Correct. If the tax proposals had been in effect in 1983, the effect on our corporation would have been about $11 million of cash-flow reduction.

Had it been in effect in 1984, it's more like $15 million.

Senator **Long**. Could you explain to me why you would reduce the drilling by 80 percent? I don't quite understand why there would be an 80- percent cut. I could understand a 20 percent, but the 80 percent sounds rather shocking.

Mr. **Terrill**. That's what my chairman has indicated to me, and it is because the risk/reward would not be present to pursue that. We could not borrow money in order to do the kind of exploration that we do.

Senator **Long**. In other words, the——

Mr. **Terrill**. It has to come out of current cash-flow, out of equity.

Senator **Long**. And the money would not be in the equity to do it?

Mr. **Terrill**. That's correct.

Senator **Long**. Likewise, if you had in mind inviting outside capital to invest, this proposal would also make it far less attractive for investor money to go into it, I take it.

Mr. **Terrill**. That's correct. The $100 million that we spend represents about 20 percent of the total effort that our partners also put into it with us. We do not take 100 percent of most of the activity that we generate.

Senator **Johnston**. Are your partners in the oil and gas business?

Mr. **Terrill**. That's correct, yes.

Senator **Long**. Well, I've heard a great number of investors say that if this proposal goes into effect, although they have participated in many drilling activities in the past, that they have participated in their last well if this goes into effect. I guess you are hearing that, aren't you?

Mr. TERRILL. We are hearing the same thing. That's correct.

Senator JOHNSTON. Would you tell us a little about how you decide on drilling a well, whether the economics are proper and how this figures into it?

Mr. TERRILL. It is a straight cash-flow calculation that is done on the basis of perhaps a 5-year projection. It can go 10 years at a time, based on the success that we would assign to the project, how many wells would have to be drilled over the block if we are successful, how many will be dry holes, and compute the—determine the cash-flow over that period of time, and it's a present worth calculation.

If it does not come back to a reasonable return on the investment, we will not do it.

Senator JOHNSTON. Well, a good wildcat, what percentage chance do you figure of hitting?

Mr. TERRILL. Well, the national average is not just on wildcats, but is one well in nine is successful.

Senator JOHNSTON. That includes development wells?

Mr. TERRILL. Yes, sir.

Senator JOHNSTON. Wildcats are much worse than that, aren't they?

Mr. TERRILL. That's correct.

Senator JOHNSTON. What are wildcats, 1 in 20?

Mr. TERRILL. Something in that order, that's correct, and we are getting out into provinces, by necessity, because Louisiana in the South is becoming a mature producing province that's going to require deeper and more risk-type exploration.

But there are significant reserves or significant sand deposits, reservoir conditions, that are known to exist, if they carry hydrocarbons, that have not yet been explored and need to be explored.

My recollection is the State of Louisiana commissioned a study a few years ago that indicated we have not yet penetrated 80 percent of the reservoirs in our State that potentially could carry hydrocarbons.

Senator JOHNSTON. But that doesn't mean that 80 percent of the oil and gas—only 20 percent is found, does it?

Mr. TERRILL. That's correct. It does not.

Senator JOHNSTON. Probably more than half of it has been found, hasn't it?

Mr. TERRILL. That's correct.

Senator JOHNSTON. And you say the economics are just not there if you can't expense intangibles; intangible drilling expense is more important even than depletion allowance, isn't it?

Mr. TERRILL. That is a known cash-flow item that you can use if you do in fact have a dry hole that would help offset the risk that you've incurred, and that, I think, is what's not taken into account in this tax proposal, the rewards of risk are not there.

Those who take no risk are treated the same as those who would take risk, and that's not the way this industry has to operate.

I would give you one other figure——

Senator **Johnston**. Well, let the record reflect that in my brief career of five dabbles in oil and gas wells, I haven't hit on a single one. So I'm about due.

Mr. **Terrill**. Let me quote one other figure——

Senator **Long**. You've got to miss four more times. [Laughter.]

Mr. **Terrill**. One other figure that I would quote, on our 1985 budget, if the tax proposal were in effect for 1985, it would have an adverse cash flow, deficit position in our company of $72 million.

The reason is that there is a large investment tax credit that would be ours if we begin capital outlays to build the "all American pipeline" from the west coast to the gulf coast as planned in this year. That would be a project that will be a regulated entity that will be paid for by the ratepayers, or the consumers in the final analysis, and anything that adds to the cost of that project will hurt them. A deficiency in cash-flow of $40 million on that project would mean additional borrowing and additional interest to be paid, and consequently higher rates on the service that would be rendered to the customer.

Senator **Johnston**. So really, rather than being—that would be a tax just directly on those consumers, wouldn't it.

Mr. **Terrill**. That's correct, exactly correct.

That concludes my statement.

Senator **Johnston**. Mr. Terrill, thank you very much. We weren't disappointed. We knew you would have excellent testimony and you did.

Senator Long?

Senator **Long**. Thank you very much, Mr. Terrill. We appreciate your statement.

Senator **Johnston**. Next we are pleased to welcome Mr. John Lollar, who is president of Transco Exploration Co. from Houston, TX.

Mr. Lollar, we are very pleased to have you come to us from Houston.

STATEMENT OF JOHN H. LOLLAR, PRESIDENT AND CHIEF OPERATING OFFICER, TRANSCO EXPLORATION CO., HOUSTON, TX

Mr. **Lollar**. Thank you, Mr. Chairman.

I believe you started off this afternoon's session by calling on the witnesses that you described as outstanding members of the State and Federal Congress.

If you wanted to describe me to the group, I think just outstanding oil and gas finder would do. [Laughter.]

I'm glad to see there are several of us in the room today.

I'm here today to represent the interests of Transco Energy Co. based in Houston. For your benefit, Transco Energy has two primary areas of business.

The first is a large gas transmission system, a transcontinental gas pipeline that starts its system in Louisiana and Texas and extends out into the Gulf of Mexico and then delivers gas up along the Atlantic seaboard, with the system terminating in Manhattan.

The second major area of business activity is oil and gas exploration, and that's the activity that I'm president of.

Our exploration activities are conducted domestically. In 1984 we spent $297 million in our exploration and development effort. About 95 percent of that was spent offshore in the Gulf of Mexico, and in the States of Louisiana and Texas, and a little bit in Mississippi and Alabama, the Gulf Coast States and the Gulf of Mexico being our primary areas of activity.

We conduct our activities through Transco Exploration Partners, which is the largest publicly traded limited partnership in the country. Our units are traded on the New York Stock Exchange.

You know, I guess I'm pleased that here today I can't find much representation of it, but I'm really shocked that someone believes now is the time to add to the domestic energy industry's problems.

It was only a few years ago that we had something that we called the energy crisis, and you referred to it in your opening remarks. I get pretty nostalgic when I hear that term used, "Energy Crisis."

I actually don't believe there was ever the crisis that it was made out to be, but it was clearly a problem, and that problem continues to exist today. It is simply being overlooked.

That problem is with us and it's going to continue to be with us as long as we continue to use, to produce more oil and gas than we find every year domestically.

Gentlemen, our business is not in good shape. Prices are going down, not up. Oil imports are on the rise again.

The latest rig count is shocking. We reached a peak in the third week in December, and since that time the dropoff has really been staggering.

Normally we see a dropoff at a fair rate, but since the third week in December the dropoff has been dramatic, and I think the most recent number I've seen is below the 2,000 number that's been mentioned today. I think it's more like 1,934 rigs working.

We haven't been at that point at this time in a year since about 1976 and 1977.

Importantly, additions of crude oil and gas reserves continue to fall short of production, and that was true even during that amazing 5-year period, 1978 to 1982, when we really had a period of very intensive domestic exploration.

We are frankly dismayed that the administration or Congress would even consider tax changes which would clearly be counterproductive to maintaining, much less increasing, domestic exploration.

However, that's exactly what will happen if this proposal becomes law. Specifically, if the Treasury's package was now law, it would substantially increase Transco's Federal tax burden by approximately $29 million in 1984. Going back and looking at 1984, that's what it would have done, increased it $29 million; and it would increase it by $47 million in 1985.

Where would those dollars have come from? Well, I can promise you they would have come out of our exploration budget. That's the largest pool of discretionary expenditures that we have; $30 to $50 million would have to be taken directly out of our exploratory effort.

Second, it would significantly impair our ability to raise needed capital for oil and gas exploratory activities.

In 1983, Transco Exploration raised $120 million by selling limited partnership interests to the public, and we used the proceeds from that sale to pay down our debt and put ourselves in better financial condition to weather the kind of storm that our industry has been experiencing.

We couldn't do that today. We couldn't raise that kind of money if the Treasury proposal were enacted.

Furthermore, the proposal would substantially reduce Transco's profitability through the proposed elimination of investment tax credits and the reduction in rates for depreciation and depletion for both tangible and intangible investments.

Given the fact that these various tax incentives which are now under attack were originally intended to, and did, stimulate increased domestic energy exploration and development, I believe their underlying justification is still very compelling; and considering the presently depressed state of our industry, such incentives are essential today.

When you look at all of the specialized taxes that are imposed on the energy industry, it is obvious that we are already one of the most heavily taxed lines of business.

We went back recently and added up all of our taxes, all of our production taxes, our severance taxes, the various escrow, income taxes, and took all that as a comparison against our taxable income, and the number came out to 49 percent.

I don't consider that to be undertaxed. In fact, to me that means that we spend about half of our year working to pay our bill, and then we spend the other——

Senator JOHNSTON. Your taxes are 49 percent?

Mr. LOLLAR. Forty-nine percent, if we add up all of our taxes and compare that to taxable income, 49 percent.

So we spend half the year to pay our bills and then we spend the other half of the year trying to pay your bill.

Please don't allow your congressional colleagues to be hoodwinked into believing that the tax simplification measures being considered are anything less than the transfer of another sizable tax burden onto the back of this industry.

Let's shift now and talk about the Treasury's recommendation that limited partnerships with more than 35 partners be taxed as corporations.

This recommendation, like the others previously discussed, would reduce exploration for new domestic reserves, thereby increasing our reliance on foreign supplies.

These financing vehicles, which Treasury proposes to eliminate, are used primarily by independent producers who, as you know, drill the vast majority of domestic oil and gas wells.

Without this traditional source of cost-effective capital, the independent producers will be forced to reduce their exploration program or be forced to seek more expensive types of financing at a time when costs need to be brought down, not increased.

Apparently underlying the Treasury's report is the assumption that large limited partnerships exist only to promote tax avoidance and abuse.

Facts indicate, however, that most limited partnerships publicized as abusive have been outside the oil and gas industry.

The use of limited partnerships in the oil and gas industry has in reality resulted primarily from the capital formation efforts of independent producers.

Treasury correctly points out that the partnership form has become more popular in recent years. This, however, should hardly come as a surprise in light of the extremely high cost of financing that has prevailed over the same period, especially for high risk or equity capital.

The effect of the Treasury proposal would be to deny another important source of equity funds to an industry already experiencing difficulty.

The scrutiny given large partnerships by the SEC and State regulators prevent them from being tax abusive. This may not be the case, however, with small partnerships not otherwise subject to such scrutiny.

Furthermore, large partnerships provide a vehicle for investors of modest means to participate directly in the oil and gas industry, while small partnerships are open only to the wealthy investor.

For example, yesterday an interested investor with $22 in his pocket could buy one TXP unit. That's $22, not $22,000 or not $222,000, but $22, and he can buy that on the New York Stock Exchange.

It's my projection that abusive tax shelters are typically structured to allow investors to claim deductions in credit which exceed the original investment by several times.

Very often, the writeoff ratio promised by these shelters is as high as three or four to one.

Large partnerships, however, do not typically have the multiple writeoff ratios that are associated with abusive shelters.

For example, the writeoff ratio for a TXP investor in the 50-percent tax bracket is 1 to 1, and that's spread over a 3- to 5-year period. It doesn't all come in 1 year.

In addition, tax deductions that are passed through to partners——

Senator JOHNSTON. Excuse me. When you say a "1-to-1 ratio," you mean you can deduct a dollar from gross income over a period of 3 to 5 years, not as a tax credit, not as a credit against your tax. So if you are in the 50-percent bracket, you can save 50 cents on the dollar, but spread over 3 to 5 years?

Mr. LOLLAR. That's right.

Senator JOHNSTON. Thank you.

Mr. LOLLAR. In addition, tax deductions that are passed through to partners represent only a deferral of tax liability, since gain on the sale of the partnership interest is fully recognized with ordinary income treatment given to recapture items.

Lastly, Treasury argues that large partnerships create difficulty for the IRS in enforcing the tax laws, despite the significant statutory changes made in 1982 and 1984 regarding partnership audits and restrictions on abusive tax shelters.

As recently as October 1983, in testimony before the Senate Finance Committee, Treasury addressed the audit problem posed by publicly traded partnerships by stating, and I quote: "We believe that many of these problems have been eliminated or substantially reduced as a result of the partnership level audit provisions contained in TEFRA." I hope everybody here knows what "TEFRA" means. It sounds to me like something you might sell door to door.

At the very least, those recent amendments should be given a chance to achieve their intended effect before resorting to Treasury's extreme current proposal.

In summary, Mr. Chairman, I believe that given the present state of our industry, it is especially imperative that you guard against the adoption of economic policies, even when they are politically cloaked in the guise of tax simplification, policies that will shift the market in favor of imported oil, increase our trade deficits, and destroy the capital formation incentives that we presently have for increasing our domestic oil and gas reserves.

In short, our product prices are coming down. Don't raise our costs now if you want an active domestic exploration effort.

Thank you.

[The prepared statement of Mr. Lollar follows:]

SENATE ENERGY & NATURAL RESOURCES COMMITTEE FIELD HEARING - MARCH 15, 1985

Testimony of Mr. John H. Lollar

President and Chief Operating Officer of Transco Exploration Company

My name is John H. Lollar. I am President and Chief Operating Officer of Transco Exploration Company of Houston, Texas, a wholly-owned subsidiary of Transco Energy Company. I very much appreciate the opportunity to appear before you today to discuss the very substantial negative impacts we believe passage of anything similar to the Treasury Department's "Tax Reform" proposal will have on diversified energy companies like Transco and most importantly on our abilities to serve the energy needs of our country.

Transco Energy Company is a diversified energy concern headquartered in Houston. Principal business operations include the purchase, transmission, and sale of natural gas (serving an eleven state market area in the Southeastern and Atlantic Seaboard states); oil and gas exploration and production (both onshore and offshore, primarily in the Gulf Coast areas off Louisiana and Texas and in the Rocky Mountain region; the production and sale of coal (Virginia and eastern Kentucky); and the manufacture of pipeline-quality gas from coal.

Based upon the experiences gained as a result of these energy related activities, and considering that: (1) 1984 oil imports have increased by 10 percent over 1983; (2) the U.S. rig count has dropped by 11.7 percent in the past year to 2011 as of March 11, 1985; and (3) additions of proved oil and gas reserves continue to fall short of production. We are frankly dismayed that the Administration or Congress would even consider tax changes which would clearly be counterproductive to increasing domestic exploration, production, and energy self-sufficiency. That, however, is exactly what will happen if this proposal becomes law.

Specifically, if the Treasury's proposal were now law, Transco's federal tax burden would increase by approximately $29 million in 1984, and $47 million in 1985. Thus, our ability to raise needed capital (especially from internal funds) which historically has been sizable, would be significantly impaired. Transco holds assets in excess of $4 billion through affiliates engaged in our various lines of business. For 1985, our total budgeted capital is $591 million, which includes $341 million for exploration and production, $7 million for coal operations, and $40 million for coal gasification. The bulk of the exploration and production expenditures will be spent in our ongoing search for new domestic oil and gas reserves. The Treasury proposal, however, would strike directly at both the economic viability of these budgeted investments and the means to finance the expenditures.

Profitablility will likewise be substantially reduced by the proposals to eliminate the Investment Tax Credit and to extend the recovery periods i.e., decrease the rates of depreciation and depletion, for both tangible and intangible investments. And although the impact of these changes would be somewhat mitigated by the proposed early repeal of the Windfall Profit Tax, lower tax rates, and dividend deductibility, these latter changes are clearly insufficient in magnitude to offset the otherwise severely negative tax implications of the plan.

As previously stated, the Treasury's plan would increase Transco's Federal Income Tax by almost $50 million if it were enacted into law for 1985. Since corporate policy calls for internal funding of exploration activity, this loss of cash flow would require a decrease in our capital budget for lease acquisitions and exploratory drilling. Estimates show that on the average we must spend $1.50 of exploration capital in order to add one Mcf of proved reserves. Therefore, a $50 million decline in the exploration budget would be expected to lower reserve additions by 33 Bcf per year.

Since Transco's annual production is in the neighborhood of 110 Bcf, we must increase our proved reserves by at least this much every year in order to stay in business over the long term. Obviously, if we were to lose 33 Bcf of reserve additions each year, we would only be replacing 70 percent of our annual production and would soon have no reserves. The only practical alternative would be a substantial contraction in our production and sale of oil and gas.

On an industry-wide basis, we estimate that the Treasury proposals regarding Intangible Drilling Costs (IDC), and the Investment Tax Credit (ITC) would take $7 billion of exploration capital away from the industry. Based on studies performed by Arthur Anderson and Salomon Brothers, this loss of capital would lower reserve additions by roughly 580 million barrels per year. Given the fact that even under existing conditions, the industry cannot replace its annual production, the loss of 500-600 million barrels of new reserves each year could be disastrous from an economic and a national security perspective.

Lastly, as mentioned above, the Treasury plan would not only lower the profitability of capital investments, but it would also make those investments more difficult to fund. This would be caused by the proposal to treat limited partnerships (with more than 35 partners) as corporations for tax purposes. This recommendation would reverse current progress toward energy independence by reducing exploration for new domestic reserves, thereby increasing our reliance on foreign supplies. This would result from the loss of cost-effective capital which is now available to the industry through the use of limited partnerships. These financing vehicles, which Treasury proposes to eliminate, are used primarily by independent producers who drill the vast majority of domestic oil and gas wells. Without this traditional source of capital, the independent producers would be forced to reduce their capital expenditures or seek more expensive types of financing which would also result in a decrease in their capital expenditure programs. Since it will be impossible to replace our domestic reserves without substantial exploration and development programs, the nation's dependence on foreign energy supplies will substantially and quickly increase, thereby threatening national security.

An issue that may be underlying the Treasury Report is the assumption that large limited partnerships exist only to promote tax avoidance and abuse. I would like to point out that most limited partnerships publicized as abusive have been outside the oil and gas industry. In reality, the use of limited partnerships in the oil and gas industry has resulted primarily from the capital formation efforts of independent producers. Treasury correctly points out that the partnership form has become more popular in recent years. However, this hardly comes as a surprise in light of the extremely high cost of financing that has prevailed over the same period, especially for higher cost or equity capital. The effect of the Treasury Report would be to deny another important source of funds to an industry already experiencing difficulty. The scrutiny given large partnerships by the SEC and state regulators prevents them from being tax abusive. This may not be the case with small partnerships not subject to scrutiny. Furthermore, large partnerships provide vehicles through which investors of modest means can participate directly in the oil and gas industry, while small partnerships are open only to wealthy investors. Abusive tax shelters are typically structured to allow investors to claim deductions and credits which exceed their original investment by several times. Very often, the writeoff ratio promised by these abusive shelters is as high as 3 or 4:1. However, large partnerships typically do not have the multiple write-off ratios that are associated with abusive shelters. For example, the writeoff ratio for a TXP investor in the 50 percent tax bracket is 1:1 over a 3 - 5 year period. In addition, tax deductions that are passed through to partners represent only a deferral of tax liability since gain on the sale of the partnership interest is fully recognized, with ordinary income treatment given to recapture items.

According to the Treasury Report, large partnerships create difficulty for the IRS in enforcing the tax laws. Despite the significant statutory changes made in 1982 and 1984 regarding partnership audits and restrictions on abusive tax shelters, Treasury continues to argue that it cannot effectively administer the law for large limited partnerships. At the very least, those recent amendments should be given a chance to achieve their intended effect before resorting to Treasury's extreme proposal. As recently as October, 1983, in testimony before the Senate Finance Committee, Treasury addressed the audit problems posed by publicly traded partnerships by stating: "We believe that many of these problems have been eliminated or substantially reduced as a result of the partnership level audit provisions contained in TEFRA."

It is imperative that government policy focus on strengthening capital formation within the domestic oil and gas industry. Toward that end, the financing flexibility provided by limited partnerships must be maintained. This policy, when combined with preserving other existing tax incentives (such as IDC and ITC), now so financially vital to the energy industry, would go far toward ensuring energy self-sufficiency and protecting national security.

In summary, the Treasury proposal in its present form would have a severe negative impact on Transco's profitability, adversely affect capital formation for new energy investments, and impair our ability to serve our customers and your constituents. Given the present state of the industry, I think it is especially important that we guard against the adoption of economic polices, even when they are clothed in the guise of tax simplification, that will shift the balance in favor of imported oil, increase our trade deficits, and destroy our efforts toward energy independence.

If it is decided that changes in the tax law are required and additional revenues are needed, a more sensible proposal would be to impose an oil import fee. This approach would moderate our increasing oil imports, encourage energy conservation, confer a relative advantage to competing energy sources such as domestic oil, gas, coal, and synfuels, and significantly promote our national goal of energy independence. I again thank you for the invitation to appear here today and will be happy to answer any questions that you might have.

Senator JOHNSTON. Thank you very much, Mr. Lollar, for an excellent statement.

Now, Transco has these limited partnerships as an important part of your capital. Industrywide, how important is it?

Mr. LOLLAR. The presence of large limited partnerships such as ours is somewhat limited. I believe that ours was only the second master limited partnership that traded on the New York Stock Exchange.

We brought that issue out in July 1983, as a way to establish the value in our exploration effort. We found that selling the units, selling the partnership units, was an efficient way to raise capital at that period of time when there weren't very many people around that wanted to look at oil and gas investments.

Senator JOHNSTON. Senator Long.

Senator LONG. I would just consider the equity involved in this thing. You know, TEFRA was supposed to mean Tax Equity and Fiscal Responsibility Act. Equity is very important and fairness is more important to the average taxpayer out there than simplicity.

If 30 people of substantial wealth go together to drill a million dollar well, they each put in, let's say, $33,300. One of them can be the operating partner and supervise and run it and be paid his expenses for doing so. That would be deductible and treated as a partnership under the Treasury proposal; isn't that correct?

Mr. LOLLAR. Yes.

Senator LONG. But on the other hand, instead of 30 people who were able to put up $33,000 a piece, if 1,000 little people chipped in to drill the same well. They passed the hat around and they found 1,000 able to put up $1,000 dollars to make up the $1 million, and again, one partner paid to run the thing and contract to have the well drilled and watch it and see that it was properly handled, then that would not be eligible to be treated as a partnership for tax purposes, would it, under the Treasury proposal?

Mr. LOLLAR. That doesn't sound very fair to me.

Senator LONG. Well, that's just the point I'm getting to. It's difficult to see what the logic of that proposal is, when in either case there's only one partner who is the active partner managing the affair. The rest of them are investors, not the active partner in this case.

The only logic I can see to it, that the rich man can have the benefit of it but the little fellow can't, is that things like that are just too good for little people and only the rich should be permitted to participate.

Can you show me any other logic for that?

Mr. LOLLAR. No, Senator, I think your logic makes a lot of sense, and I am glad you are going to be in Washington for the next 2 years to try and make sure that message is powerfully conveyed.

Senator LONG. It always seemed to me that the oil and gas business offered the little fellow a chance; if he worked hard and if he had a lot of luck to go along with it, it offered him a chance to be very successful, to make something, be a self-made person.

I suppose you've had the same experience I've had. I've known a great number of people who just by dint of hard work and being willing to take one tremendous chance, willing to risk everything they had to try to find some oil somewhere, were fortunate and were very successful people.

For every one of them like that, you could probably find 50 of them who lost everything they had and had to go into something else, but those who had the good fortune to find something started out very small, probably couldn't put up but $1,000.

It absolutely befuddles me trying to figure what possible logic can there be to say that this is all right for a rich person, it's perfectly all right for him to have the benefit of partnership treatment, but it's just too good for a little fellow. Little folks shouldn't get that kind of tax treatment; it's too good for them. It's all right for the rich, but too good for the middle-income people.

I personally think that would be very unfair, just as you have pointed out in your statement.

Mr. **LOLLAR**. Yes, sir.

Senator **LONG**. Thank you very much.

Senator **JOHNSTON**. Thank you very much, Mr. Lollar.

I wanted to thank Jess Johnson, who is vice president of Shell Oil, who is in the audience, and who will be giving a report, which we'll put in the record,[1] on the effect of this tax proposal on the tertiary recovery program. Thank you very much for that, Jess.

Next, we are very pleased to welcome Mr. Jim Bob Moffett, chairman of the board and chief executive officer of Freeport McMoRan, a great Louisiana company now since Jim Bob has taken over as chairman of the board and chief executive officer. He is an outstanding man in oil and gas and a good friend of both Senator Long and mine.

Jim Bob.

STATEMENT OF JIM BOB MOFFETT, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, FREEPORT MCMORAN, NEW ORLEANS, LA

Mr. **MOFFETT**. Well, it's always nice to come talk to friends and it's always nice to have a good environment like you are creating to be able to discuss a very difficult problem, and hello to both of you.

Thank you for giving me the opportunity as a Louisiana citizen and Louisiana corporate citizen to talk to you about this tax proposal, because as you might imagine there's been a lot of talk about it at lunch and at dinner and at various meetings. I think for you to take the time to come down here and hear what we're saying down here is going to be most beneficial to our peace of mind that we are being heard.

So I, along with, I'm sure, my other colleagues, thank you for this opportunity to talk about this where it can be heard.

Gentlemen, first of all, Freeport McMoRan, as Senator Johnston has already said, is a Louisiana company. We have about 4,500 employees worldwide. Over half of them are employed in Louisiana.

These are just the employees that directly are employed and on our payroll. The thing that I want to point out to you is that in addition to the—did I say something to upset Channel 6? [Laughter.]

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[1] The report referred to appears in the appendix to the hearing record.

In addition to the employees that we have on our payroll, we as an operator have done business with 7,300 companies this year who also employ thousands of people in Louisiana.

So not only do I speak for the 4,500 employees, half of which are employed in Louisiana that are Freeport McMoRan employees, I speak on behalf of the 7,300 vendors, which is the average number of people that we have dealt with in our operations, principally in oil and gas, in the last 4 years.

I might add, so that you can get an idea of the kind of money that we have put into the economy, that we as operator for ourselves and other joint venture partners, in 1981 spent $1 billion in oil and gas; 1982, $700 million; 1983, $400 million; and approximately the same amount in 1984.

The first thing that's going to hit you is why did we go from $1 bilion in 1981 to the $400 million level in 1983 and 1984. That was necessitated by the fact that our prices have softened and our cash flow has contracted such that we had to reduce the amount of expenditures that we made in the oil and gas business.

Again, this contraction of our ability to spend money has had nothing to do with the tax proposals I am fixing to discuss; but it is significant when you look and see what the contraction of the prices that we're getting for our products at the wellhead has done to our cash flow so that we have had to reduce our investment.

I might, as a parallel, point out to you that nationwide public drilling funds, funds of risk capital that were raised by the industry, have dropped in that same time from $2 billion in 1981 to $1 billion in 1982, to $754 million in 1983 and to $400 million in 1984. Those figures show a very good parallel to what happened in our own company.

Why did those numbers drop? They didn't drop as a result of these tax proposals, but they dropped because of the basics of our industry, and that is that the perception that the industry was once a good place to spend money. Because of the softening of OPEC prices and because of the perception that the return on the investment in the oil and gas business was diminishing, it became more difficult over the last 4 years to raise this risk capital.

So we must set the stage that at the time these tax proposals were presented to us in 1984 and in 1985, as they became reality, this is right on the heels of an industry that's been contracting because its cash flow and its image has been tarnished by the price reduction of its product at the wellhead.

So I think that it must be understood that this is not a buoyant time in our industry.

Now let's talk about the proposals that we address ourself to in 1985 in the midst of this certainly nonbuoyant industry.

There have been some statistics discussed nationwide and Louisiana-wide, so not in a sense of being selfish about our company, but something I know most about, I want to give you what this means to us.

In the next 4 years our taxes will be increased by $240 million.

Senator JOHNSTON. If this passes.

Mr. MOFFETT. Freeport McMoRan, a company that has $1 billion in revenues, will pay $240 million worth of additional taxes over the next 4 years.

Now, what would be the effect of this? There would be a 23-percent decrease in our exploration activities over the next 4 years for one simple reason: the cash flow that we are going to give up to pay these additional taxes will have to come 100 percent off of our exploration budget.

The one thing that we've got to get across in today's world is you can't borrow exploration dollars. We had a euphoric attitude in the middle eighties—excuse me, in the first of the eighties, where people got confused about where money had to come from to wildcat with.

Unfortunately, some of the banks and other financial institutions in this country found out that if you confuse lending money against production against lending money for wildcat drilling, you aren't going to be very happy with the results 5 years henceforth; and we are all paying the price for that very ill-advised decision.

But in euphoric times, when prices were thought to be going to $100 a barrel and gas going to $10 an Mcf, very difficult decisions were made by the financial community because they were in a euphoric atmosphere. They thought wildcat drilling was a cinch to be financially successful.

We have some of our greatest institutions today that have felt the brunt of those decisions.

So we can't borrow money to do wildcat drilling. We have to generate this money through cash flow and have it be done out of our spending—our shareholder's spending.

So 23 percent of our activity will be decreased over the next 4 years so that we will be able to pay our taxes.

Let me tell you the real difficult part about that. If we don't drill the wildcat wells, then we also are not going to find the discoveries. For every $1 we spend in exploration, we generate an additional $1 that we spend on development drilling.

We can borrow that money, so all of a sudden we have $1 we spend turn into $2 that gets put into the economy.

But if we don't spend the first dollar, if we don't prime the pump with that exploration dollar, away goes all this platform construction, away go all of these multiple drilling platforms, and these development wells, and these production facilities.

Those moneys are not going to get replaced. So it's a domino effect. As the exploration dollar stops, it's more than just a direct 1-to-1 ratio. The development dollars that we can borrow are going to be reduced.

So the amount of exploration that we're talking about, the number of people involved, jobs, et cetera, that we've just discussed, are certainly an important factor for Louisiana.

But let me say that along with some of my other colleagues, my biggest concern is that I am outraged by the fact that we are having to sit here today and one more time defend against the fact that we can't stand any more problems if we are going to be energy independent in this country.

I think the facts are today that we ought to be looking for new incentives to create the industry's ability to rebuild itself. With the fact that our cash flows have been contracted, which has led to the reduction of expenditures by our company and many others, it has resulted in industry consolidation. We've seen mergers; we've seen buyouts. There wasn't anybody merging or buying out when oil was selling for $40 a barrel and gas was selling for $6 an Mcf.

These price contractions have forced the industry to run for cover. So who's left? The major oil companies are left. The independent ranks are depleted.

Thank goodness that we and a few independents did survive and have cash flow to put into the industry. But the independent ranks are depleted. People are either gone or they are so financially strapped that they are not able to invest in risk capital ventures.

We've got to leave our American energies so that we can be creative. Saying that we can't form a master limited partnership—incidently, we announced $1 billion master, limited partnership this morning. We think it's an excellent vehicle to let the public participate on a ground floor basis in our exploration.

I, like the Senator, and my colleague, John Lollar, can't imagine that there's anything wrong with us giving the little people, the public investor, an opportunity to invest in oil and gas, albeit the fact that they know it's a risky business. And I can't understand why we want to tax it as a corporation. I thought we were trying to tax people, not things.

People in these partnerships, the limited partnerships, are taxed on an individual basis, just as if it were a taxation of one entity. So the tax is not avoided. The tax is passed on, and in some instances the participants in these master, limited partnerships will be in higher tax brackets than the corporations that would be paying the tax.

So surely we have enough commonsense, surely we are not in such a euphoric state to think that we want to stifle the creative ability of this industry to raise capital.

We can't do that at a time when we are going to be tested beyond our wits. We are always out of cycle in this country.

The gas bubble that is created by having more gas available than we can use right now wasn't created by the price structure that exists today. It was created by the price structure that existed in the late 1970's and early 1980's when we had the incentive to seek people out and by getting the rig count up to 4,500 rigs a day.

So what we are doing is we get out, when we get the incentives, we get the money spent, we get the wells drilled, we get the problems solved, we get the gas stations where you don't have lines in it, you get enough gas that you don't have to think about a Fuel Use Act that has never been repealed. What do we do next? We become euphoric and we knock the props out from under the industry by taking away the very incentives at a time when the industry has had its cash flow depleted to the point that only the strongest have been able to survive.

It really doesn't make any sense and it really is not fair.

We in this country have to understand that today we are consuming 23 million barrels of oil and oil equivalents. In 1984 we spent $35 billion as an industry. At $11 a barrel, that only replaced approximately one-third of those barrels that we produce today.

This industry, at $11 a barrel, which was the industry average to find oil and gas in 1984, would have to spend $92 billion to replace the 23 million barrels and barrel equivalent that we are producing today.

Senator JOHNSTON. Excuse me. Would you repeat that? You say you only found a third as much last year as we consumed?

Mr. MOFFETT. That's correct, sir. In other words, if you translate into dollars what we found, we found exactly a third, because remember, half of the oil we are producing today, we are importing; but the facts are we are still using it.

And my statement is that at a time when we ought to be spending $92 billion, and that's assuming, incidentally, that we could find as much oil and gas with the other $60 billion we would spend as we did the first $34 billion.

Unfortuntely, as you start spending more money, that's when competition increases and you have to go out into these wilder frontier areas, and all of us that have seen the billions of dollars spent by this industry on unsuccessful efforts at Baltimore Canyon and George's Bank know what that can get you.

It hurts, just like those five dabbles that you had, Senator Johnston. That money spent and all you get for it is somebody mad at you because you might have messed up the waters that you drilled in out there.

So it's a tough business and it's a business that needs risk capital, and we need incentives in our industry today to offset the fact that our price structure has fallen out from under us.

There's a total lack of confidence on Wall Street in the ability of the oil and gas business to make a profit today, and we need to let the oil and gas companies be as creative at raising money as they have to be at finding oil and gas.

But I'll tell you this, if we leave the tax proposals on the table and leave the indecisiveness on Wall Street where people don't know what the ground rules are, we're not going to be able to raise an umbrella in a rainstorm, because people in the investment community will not commit themselves if they don't know what the ground rules are.

We've got to get these things off the table. We've got to come up with a fair solution to this so this country can get about what it's got to do to solve its energy problem. The uncertainty is going to kill us.

Senator JOHNSTON. What you are saying is it is hurting you right now in your ability to raise capital, even without it being passed?

Mr. MOFFETT. Absolutely. Everybody you talk to, the very first thing they want to know is what if the intangibles are taken away, et cetera, et cetera, et cetera. All they want to do is talk about the problems, and it's because they don't want to invest in something and look at some parameters and say, "Well, I'm going to spend my dollar, but if this all changes, what's my return going to be?"

We can't give them any x, y and z's. But I will tell you this, that we can't deal with uncertainties in our business. We have enough uncertainties trying to find oil and gas.

If we've got to be uncertain about the rules of how we are going to be able to account for the expenditures we make in this business, then people are going to put their money in CD's and they are going to put them in commercial paper.

As we've stated before, if we are going to have the same tax treatment of risky investments as you do of safe investments, people are just going to play it safe. When we do that, we are going to grind to a halt.

I don't want to take any more time. I think my sentiments come right across this microphone and both of you know me well enough to know we're serious about what we're doing. We've gotten the job done, but we can't do it with handcuffs on, and these tax proposals will severely hamper this industry. It will severely hamper us, and it will lead to severe problems in the 1990's.

We'll be right back in the energy crisis of the middle 1970's that was so well publicized, and how soon we forget.

I don't see how we can be so out of faith with the reality on our need to be dependent on our own resources and our own natural resource base.

It's a risky business. It's one that must be done. It has to be done by professionals and we need all the risk capital we can do to support our ideas.

Thank you very much.

Senator JOHNSTON. Thank you very much, Mr. Moffett, for an excellent and really a powerful presentation.

I hope we can translate this word back to Washington as effectively as you've given it to us.

Mr. MOFFETT. If you need any help, I can get up there. [Laughter.]

Senator LONG. I'd like to just speak to the witness for a moment, if I may.

Senator Kasten of Wisconsin on behalf of himself and some other Senators—maybe you know, Senator Johnston, what other Senators joined him in offering that amendment, to say on the budget resolution that is sent to the Senate that the Finance Committee should report in very short order on this proposed simplification bill. That's a bill and the administration has not yet finalized its recommendations.

Without even knowing what the bill is, we are now being told by an amendment agreed to by the Budget Committee, which Senator Johnston voted against——

Senator JOHNSTON. The vote was 10 to 9.

Senator LONG [continuing]. To try to order or coerce the Finance Committee into reporting this measure before they have had an adequate opportunity to consider it, hear the witnesses or to accord the people out there in the four corners of the United States the opportunity to write in and express themselves to their Senators and Congressmen and matters of that sort.

Now, this is an effort to use the bum's rush approach to legislation which would tend to crucify some industries, such as yours.

You have difficulty in defending yourself, just one industry picked out for political reasons for especially adverse treatment, as has happened before; but you aren't the only one who will be adversely affected if this bum's rush approach is to be used to ram something down people's throats before they have an adequate chance to defend themselves.

I had the opportunity this morning to discuss that problem with some other men, two of whom are outstanding members of the Business Roundtable. Both of them are chief executives of major corporations.

Both of those men have been chosen to nead committees of the Business Roundtable, which is a very influential group of businessmen in America, chief executive officers.

They are both outraged to think that this type of approach would be used to ram through what amounts to a $45 billion tax increase on business when in full operation in 1990. All of them felt that it was just unthinkable from their point of view to use such roughshod legislative tactics to impose a $45 billion tax on those who are going to have to pay the tax increases in this bill.

The impression I gained was that those people will urge all their friends and colleagues to unite across the board of American industry and American commerce to fight for the right to have a fair hearing so that everybody will have a chance to be heard.

Now, the kind of approach that's being sought by Mr. Kasten and his associates would mean that the entire industry of the whole United States, all those in 50 States producing energy wouldn't have as much opportunity to present their case before the Finance Committee as you and the other witnesses are having here in this 1 day.

I think you've seen how the Finance Committee operates. When we are trying to move on and get something done in a hurry, we have three lights on in front of the chairman, a green light, a yellow light, a red light, and the result is that you will be told you have 5 minutes to summarize your statement or print your statement in the record.

They would like you to think that people are going to read that statement. Well, some will, but not many. For the most part, that's your chance to have your say. You've got 5 minutes there, and in 5 minutes that green light has turned to yellow and to red, and you are through unless somebody wants to ask you a question.

That's all the say you are going to have a chance to tell that committee.

If the committee is not required to rush so rapidly, you have more like the chance you've had here. You can go ahead and finish your statement, say what you have in mind, and if we have the kind of legislative procedure you ought to have, you can also look up there and see who's there on that committee.

If your Senator is not there, then you can head down the hall looking for your Senator and find out where the devil he is and insist that he hear what you have to say, and if he wasn't there, you tell it to him personally.

That is the type of fairness that the Kasten motion would seek to deny people like you have heard here today, the opportunity to make their case and have their facts considered.

Of course, the argument there is that if we let these special pleaders, which is not just you, Mr. Moffett—we are talking about the business community in the entire United States. We're talking about the steel industry, the automobile industry, the insurance industry, the real estate industry. We're talking about all of them.

The whole thought here is the whole bunch of you business people, not just the oil people, but all of you, are not really worthy of full consideration.

Someone got a popular idea that in the name of simplicity put a $45 billion tax increase on the business community and to have a tax cut for a great number of other people who don't expect it, not asking for it and be surprised to get it, because nobody said anything about it, even in the last election, which has a certain merit to recommend it; but on the other hand, has a lot of things that need changing in that package and that need careful consideration.

I would like to suggest that you consider alerting your friends across the Nation. You have many friends in your business and you have directors and they know other people and they have associates, too; that they should join together to take on Mr. Kasten and his people when that budget resolution comes up on the floor, because as far as I'm concerned, I'm going to make a fight to change that sentence of the Senate resolution which instructs us to put this matter out in a brief period of time.

Theoretically under that thing, by the time we see what the final form of the bill will be, it might be that we are supposed to report it within a week or even a day, by that time.

That's not binding, they can't force us to do it, but the whole idea to try to make us give you people the bum's rush and ram this thing on through without giving you much opportunity to present your case or urge someone to consider it.

I'm against you being treated that way. I'm against everybody in this room being treated that way, and I'm against the entire business community, everybody in it being treated that way.

I think that if we are going to put a big tax on somebody, they are entitled to a fair chance to defend themselves and to make their case.

You made a fine presentation here and so have the other witnesses, and I just wanted to alert you that we are in for a good fight.

If we can't win this fight for a fair hearing, we can't win anything.

Mr. MOFFETT. I agree with you a hundred percent, Senator Long, and I'm glad we've got you up there along with the good Senator Johnston to make sure that that doesn't happen.

We all know that the deficit is a huge problem and there are many other problems up there. Solving these problems takes time, just like it took us 2 years to get the natural gas deregulation bill done. We all remember the long weary hours that we spent on that.

Our concern is that I don't know whether we can stand a 2-year period on Wall Street with the uncertainties that are presened by having this tax proposal in place. It's going to be very difficult for us to operate if we have that kind of a problem.

So I hope that somehow we can get a fair hearing and that we can get the deficit and all the other situations understood; but I really think that when you get to the roots of it, since this is so important to capital formation in the oil and gas industry, the real estate business and all the other industries, we've got to get the ground rules in place if possible.

So I hope there's a reasonable promise for a fair hearing and I also hope to get this uncertainty out of the minds of our equity capital funders up there who really don't want anything but eights and straights and flushes. These guys want eights and straights and flushes.

Senator LONG. The point I want to make to you is the opportunity of people to have an adequate hearing, an adequate opportunity to make their case, and the right of individual Senators to debate at length, if need be, what they regard as an unsound proposal is a fantastic weapon for defeating bad legislation or for knocking out of legislation bad provisions that never should have been there or to change them if need be.

An effort is going to be made to see that if those tools of statesmanship are not available to those who take your side, I think you ought to know about that, because Senator Johnston voted right on that, but he was behind by a vote of 10 to 9.

They are going to bring this budget resolution up under a modified gag rule where we're told there's only 50 hours to consider that matter when it's under full Senate. Other measures you can debate them indefinitely, but only 50 hours will be available.

So we won't have a lot of time to make the fight, but 50 hours is enough, provided the business community gets busy and does their part. We ought to win that one. I think that we ought to accept the challenge, and I think we'll win it.

Mr. MOFFETT. Anything we can do to help you, and if one of your aides will be specific about what you'd like for us to be doing, please know that we've always supported you and we will do our part.

Senator LONG. Thank you very much.

Senator JOHNSTON. Mr. Moffett, let me ask you one question.

Some of my colleagues who don't like this Treasury bill are saying that the best defense against the bill is a good offense, and they are proposing a minimum corporate tax in the neighborhood of 15 percent. That's one proposal I specifically know about that one of my colleagues came by the office the other day and told me about that.

How would a minimum corporate tax, say of 15 percent, affect the oil and gas industry? I'm not asking you to ask for it, and I haven't committed myself for it yet.

Mr. MOFFETT. I understand. Well, I think the best way to answer that question is that the 15 percent minimum corporate tax would do the same thing to some extent that I've outlined today.

It again would say that even though you are spending risk capital and spending the kind of money that you need incentives for, you are going to have to pay your tax anyway. So it would definitely again be a case of pulling back our cash flow and having to have that 15 percent there as opposed to getting tax credits for spending money on risk capital investments.

But obviously, I'm not prepared to give you specifics on the 15 percent, but I can say that a tax proposal that says that you are going to have to pay taxes as opposed to spending money on risk capital ventures or ventures that are good ventures for the economy and for the Nation that you don't get tax credits for if they are risky ventures is going to reduce the amount of those kind of ventures that you spend——

Senator JOHNSTON. I wish you would, at your leisure, think about that question and let me know, because it's likely to come up rather quickly.

Mr. MOFFETT. I'll get you some information on how it compares to the numbers I gave you on the current proposal.

Senator JOHNSTON. That would be excellent.

Thank you very much indeed, Mr. Moffett. I appreciate that.

Next we have Mr. Hugh J. Kelly, chairman of the board of Mid-Continent Oil and Gas Association in Baton Rouge, La.

Mr. Kelly, welcome to the committee. We are always pleased to hear from you and from Mid-Continent. You are accompanied by Mr. Bob Brookshire, our old friend.

STATEMENT OF HUGH J. KELLY, CHAIRMAN OF THE BOARD, LOUISIANA MID-CONTINENT OIL AND GAS ASSOCIATION, BATON ROUGE, LA, ACCOMPANIED BY BOB BROOKSHIRE

Mr. KELLY. Thank you, Senator Johnston, for having the hearing and inviting Mid-Continent. As well as Mid-Continent, I'm also president and CEO of ODECO, but I'm wearing the Mid-Continent hat today.

Rather than repeat some of the statistics you have already heard, I thought I'd give you a break here. We submitted our statement and the API studies and the like.

If I can just pick up some of the more interesting consequences of the legislation in numbers, we can do that and then answer any questions you might have.

Some of these are well known. In this State there are over 105,000 employees working directly in our business with a $3.2 billion payroll.

It contributes to the state about $800 million annually in severance taxes and approximately $500 million additional dollars in royalties and bonuses.

Earlier today they alluded to Dr. Scott's study that Mid-Continent sponsored. In his study he concluded that for every new job created from the sales in oil and gas production, two jobs are created elsewhere in the Louisiana economy. And for every new job created in the refining industry, six new jobs are created elsewhere in Louisiana.

Also, offshore oil and gas activity has created jobs for another 125,000 people and generated $1.8 billion in Louisiana household earnings in 1 year.

Again, skipping some of this and getting to the API study on their estimates of the consequences of these tax changes.

Their central finding is that there will be an average reduction of 500,000 barrels per day of oil equivalent in 1986; 1.1 million barrels per day in 1990; and 1.5 million barrels per day in 1995.

They state that total drilling will decrease by about 17 percent, with exploratory drilling showing a slightly higher decrease.

The survey concludes by stating that, "The tax proposal will have serious long-term impacts on the domestic petroleum industry. Drilling activity, especially exploratory drilling, would be impacted almost immediately and would soon result in smaller reserve additions and eventually lower production levels."

In addition to this API study, others have gathered facts showing the consequences of the Treasury proposal.

The Interstate Oil Compact Commission estimates the United States will lose 1.8 billion barrels of discovered but unrecovered oil and $1.3 billion in Federal income tax collections if the Regan Treasury proposal is adopted.

It also estimates that there will be a loss of 90,000 oil production related jobs in the first year of the tax changes.

The Interstate Oil Compact Commission study deals especially with the effects on stripper wells, enhanced recovery and general petroleum production from the loss of the depletion allowance.

There was one interesting statement in it. In the first year after the tax proposal was in effect, 849 million barrels of proven developed oil reserves would be lost as the stripper wells are plugged and abandoned.

This compares to the 450,900,000 barrels stored in the national strategic petroleum reserve at a cost to the taxpayers through fiscal 1984 of $14½ billion.

The Petroleum Industry Research Foundation also had some comments on this. Mr. John T. Lictblau, president of the foundation, is concerned that the Treasury has proposed the change because of its misperception of the oil industry's tax burden.

He cites a study of the Joint Committee on Taxation of Congress which shows that the 1983 average U.S. tax rate is 16.7 percent on U.S. income for all its sample companies, while there is a rate of 21.3 percent for the petroleum industries alone.

If the oil industry's special so-called windfall profits tax were also to be considered, the petroleum industry's Federal tax payments per dollar of income would be still higher.

It's true that the Treasury plan does offer a corporate tax rate reduction from 46 to 33 percent. However, after careful analysis, because of the repeal of certain tax incentives, such as the Investment Tax Credit and the Accelerated Cost Recovery Program, corporate tax collections would actually increase by more than 30 percent, which would particularly affect the oil and gas business.

Senator JOHNSTON. Well, you know, we usually find that any time they put the word "reform" on a tax bill, it means higher taxes.

Mr. KELLY. Terrible things have been done with that word.

I think those are the central parts of those studies, and we'd be pleased to answer whatever questions you might have.

Senator JOHNSTON. Thank you very much, Mr. Kelly. You pointed out what Interstate Oil Compact Commission said about the reduction in stripper wells nationwide.

In Louisiana we have a very high percentage of stripper wells, do we not? Mr. Kelly: We sure do.

Senator JOHNSTON. Do you recall that figure?

Mr. KELLY. Six percent is stripper well production.

Senator JOHNSTON. Six percent of our production is stripper wells. That is a very sizable amount of oil, considering the amount of oil we produce in this State.

Mr. Kelly, thank you very much. Your testimony has been very helpful. We will put your entire statement, also, in the record.

[The prepared statement of Mr. Kelly follows:]

Statement of

HUGH J. KELLY

Chairman

Board of Directors

Louisiana Mid-Continent Oil and Gas Association

before the

Senate Committee on

Energy and Natural Resources

March 15, 1985

New Orleans, Louisiana

Senator Johnston, members of the committee, my name is Hugh Kelly and I am President and Chief Executive Officer of Ocean Drilling and Exploration Company with headquarters in New Orleans, Louisiana. Today, however, I am wearing another hat as I am appearing as the Chairman of the Board of the Louisiana Mid-Continent Oil and Gas Association. This organization is made up of all segments of the oil and gas industry in Louisiana and our membership is responsible for over 92% of all the oil and gas produced, transported, refined and marketed in this state.

It is a pleasure for me to appear before you today to give our association's views on the impact of the Regan tax proposal titled the "Tax Reform for Fairness, Simplicity and Economic Growth". First I would like to furnish for the record some facts about the oil and gas industry in this state.

The first oil well in this state was brought in in 1901 and Louisiana has been a major contributor to the energy supply of the United States ever since. At this time in the United States, Louisiana ranks second in natural gas production and third in crude oil production. In this state there are over 105,000 employees working directly in the oil and gas industry with a $3.2 billion payroll. It contributes to the state about $800 million dollars annually in severance taxes and approximately 500 million additional dollars in royalties and bonuses.

Dr. Loren Scott, a noted Louisiana economist, states that for every new job created from sales in oil and gas production, two jobs are created elsewhere in the Louisiana economy and for every new job created in the refining industry, almost six new jobs are created elsewhere in Louisiana.

Dr. Scott further states that the oil and gas industry offshore Louisiana creates jobs for another 125,000 people and generated $1.8 billion in Louisiana household earnings in one year.

By these few statistics you can see that the oil and gas industry plays a most vital role in the economy of Louisiana. Anything that affects the health of this industry affects the health of Louisiana. In fact, studies show that a drop in the price of oil of one dollar per barrel will reduce the annual income of this state by approximately $37 million.

With those few facts in mind let me move to the Regan tax proposal. While I am not exactly sure what the Treasury Department intended with this tax proposal, I have been led to believe that it is intended to be revenue neutral overall. I do know that it is a large change in the tax load from individual taxpayers to business in general. On the business side the shift is more toward capital intensive industries and within this group to an already highly taxed oil and gas industry.

On us, then, it certainly is not "revenue neutral" and will lead to a significant reduction in oil and gas production. We will have to curtail many of our contemplated projects and the projected life of others could be reduced.

The American Petroleum Institute made a survey of major oil companies's estimates of the petroleum production consequences of the tax changes. Their central finding is that there will be an average reduction of 500,000 barrels per day of oil equivalent in 1986, 1.1 million barrels per day in 1990 and 1.5 million barrels per day in 1995.

They state that total drilling will decrease by about 17% with exploratory drilling showing a slightly higher decrease. Just the loss of the expensing provision for intangible drilling costs will cause an estimated net percentage decrease in exploratory drilling activity of slightly over 13% and development drilling of an average of about 12%.

Lower drilling activity due to the enactment of Treasury's proposals is expected to result in smaller annual additions to the reserves of crude oil and natural gas. On average, annual reserve additions of crude oil would be about 10% smaller than under the current law in the period 1986 - 1990 and about 8% smaller between 1990 and 1995.

The survey concludes by stating that the tax proposal would have serious long-term impacts on the domestic petroleum industry. Drilling activity, and especially exploratory drilling, would be impacted almost immediately, would soon result in smaller reserve additions and eventually lower production levels. This loss in production would have to be replaced by an increase in imports.

I am enclosing with a copy of my remarks, a full copy of the results of the API survey.

In addition to the API study others have gathered facts showing the estimated consequences of the Treasury proposal. The Interstate Oil Compact Commission estimates the United States will lose 1.8 billion barrels of discovered ~~by~~ But unrecovered oil and $1.3 billion in federal income tax collections if the Regan proposal is adopted. It also estimates that there will be a loss of 90,000 oil production related jobs in the first year of the tax changes.

The study by the Interstate Oil Compact Commission is very detailed -- dealing specifically with the effects of the Regan proposal on stripper wells, enhanced oil recovery and general petroleum production from the loss of the depletion allowance. I will not discuss the study further except to quote one brief statement. In the first year after the tax proposal is in effect, "849,000,000 barrels of proven developed oil reserves would be lost as the stripper wells are plugged and abandoned. This compares to 450,900,000 barrels stored in the National Strategic Petroleum Reserve at a cost to the taxpayers through fiscal 1984 of $14,500,000,000." I am enclosing a copy of the IOCC study with my written remarks.

The Petroleum Industry Research Foundation is in agreement that the tax proposals would have a most adverse effect on the domestic petroleum industry. Mr. John T. Lictblau, president of the foundation, is concerned that Treasury has proposed the change because of its misperception of the oil industry's tax burden. He cites a study of the Joint Committee on Taxation of Congress which shows that the 1983 average U. S. tax rate ~~of~~ IS 16.7% on U. S. income for all its sample companies while there is a rate of 21.3% for petroleum companies alone. If the oil industry's special "Windfall Profits Tax" were also to be considered, the petroleum industry's federal tax payments per dollar of income would be still higher.

It is true, as I understand the plan, that the top corporate tax rate would be reduced from 46% to 33%. However, we feel that after careful analysis, that because of the repeal of ~~some things~~ CERTAIN TAX INCENTIVES such as the Investment Tax Credit and the Accelerated Cost Recovery System, that corporate tax collections would actually increase by more than 30%. This would particularly ~~a~~effect the oil and gas industry.

For the U. S. to maintain its present production levels, 70 to 80 percent of our oil and gas needs ten years from now must be met by reserves not yet discovered. This objective cannot be reached by a reduction in drilling activity.

Nationally we must maintain a healthy petroleum industry by reducing imports to better our balance of payments and protect our national security. All of our government officials agree to this.

While it is true that there is a public clamor for tax simplification, I would suggest to you that it must be done in a way that is not counter productive. An abundant supply of energy and an enterprising people have made this country the greatest in the world. Take away the energy and there is nothing for the people to be enterprising with.

If a producing company cannot keep up its reserves -- that is -- find more or as much oil and gas as it has -- it will soon cease to exist. This would seriously affect our ability to supply this country's energy needs.

Because there is an "oil glut" and a "gas bubble" at present, many people think all is right with our energy supply. This temporary abundance hides many dangerous trends.

The U. S. outlook for oil and gas supplies is already changing for the worse. Demand and consumption in the U. S. are up while drilling and exploration are down. Reserves are falling. Imports are up 10% over last year. We could soon find the OPEC influence over our economy returning.

The tax proposal is not good for our country or Louisiana. When it is considered by the Senate, I would urge your rejection of the concepts therein expressed.

Yes -- the title of the proposal sounds good "Tax Reform for Fairness, Simplicity and Economic Growth" but good sounding words don't necessarily make a good proposal. If it weren't for the deductibility of interest payments, we would have a lot less homeowners in the U. S. If it weren't for Investment Tax Credit, Accelerated Cost Recovery System, current year expensing of intangible drilling costs and percentage depletion we would soon become totally energy dependent on others. The Regan tax proposal is not in the national interest.

IMPACT OF THE TREASURY DEPARTMENT'S PROPOSAL "TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH" ON DOMESTIC DRILLING AND PETROLEUM PRODUCTION ACTIVITIES

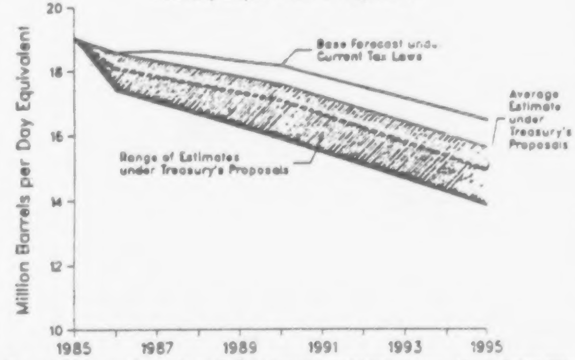
MARCH 4, 1985

SUMMARY

Enactment of the Treasury Department's proposal, "Tax Reform for Fairness, Simplicity, and Economic Growth", would lead to a substantial reduction in the volume of U.S. crude oil and natural gas production. Based on a survey of major oil companies' forecasts, enactment of the current proposals would result in an average estimated reduction of about 500 thousand barrels per day of oil equivalent production in 1986, 1.1 million barrels in 1990, and 1.5 million barrels per day by 1995 (see Exhibit I).

Exhibit I

Total Petroleum Production* Forecasts under Current Tax Laws and the Treasury Department's Proposals



Source: Base forecast, Dept. of Energy/Energy Information Administration--Annual Energy Outlook 1984
API Survey of Major Oil Company Forecasts
* Includes crude oil, natural gas, and natural gas liquids

The above estimates represent the average of the range of forecast estimates supplied by the companies responding to the API survey; as such they represent only one possible outcome of the proposed changes in the tax laws. Despite this uncertainty, it is clear that changes in the tax treatment of certain costs associated with petroleum exploration and production activities would have an increasingly negative impact on domestic production. Just the repealing of the current provision allowing the expensing of intangible drilling costs would seriously slow domestic exploration and drilling activity. Eventually, decreases in domestic production would have to be replaced by higher levels of petroleum imports, increasing our reliance on foreign sources and putting more demand pressure on prices.

BACKGROUND

The Treasury Department's proposal as currently written would substantially alter the tax treatment of many of the costs associated with the discovery and production of crude oil and natural gas in the United States, and would eliminate the percentage depletion allowance, an important source of cash flow for many independent producers. The impact of these changes would be partially offset by reductions in marginal income tax rates and the deductibility of a portion of paid-out dividends and the indexing for inflation of depletable costs.

In order to assess the net impact of these possible tax law changes, several oil companies, who normally forecast U.S. oil and gas production, were asked to compare their forecasts of production and drilling activity under current tax laws with their forecasts under the proposed tax law changes. The companies were asked to provide the API this information for the years 1986, 1990, and 1995 (a copy of the questionnaire is attached).

Seven companies provided estimates of the net percentage change between their base forecast and the after-tax-change forecast levels for drilling, production, and reserve discoveries. Not every company responded to every section of the questionnaire; however, at least five companies responded to each section. The companies also were asked to provide estimates of the impact of the major tax treatment changes without any offsetting reductions in marginal tax rates or paid-out dividend deductions.

No actual forecast levels were asked for or provided by the participating companies. Volumetric estimates in this summary are derived by applying the corresponding net percentage change from the survey to the base forecast levels in the Department of Energy, Energy Information Administration's Annual Energy Outlook 1984.

Experience in recent years has demonstrated the uncertainty inherent in forecasts of petroleum supply. In this case, the normal uncertainty about future values of such important parameters as interest rates and world oil prices is compounded by the possible impact of the tax law changes on these same parameters. Because each forecast was prepared independently, it was hoped that the most likely outcome of the changes would be bracketed by the range of estimates produced as a result of different assumptions about the behavior of the critical variables.

SURVEY RESULTS*

Table I

Estimated Net Percentage Decrease in Drilling Activity Due to the Treasury Department's Proposals

Forecast Year	Total Drilling			Exploratory Drilling		
	Average	High	Low	Average	High	Low
1986	17.0%	28.0%	5.0%	20.2%	41.0%	6.0%
1990	17.0	22.0	10.0	18.8	33.0	10.0
1995	13.8	22.0	8.0	14.8	23.0	5.0

Drilling Activity

Drilling activity is expected to decrease substantially as a result of the Treasury's tax provisions; large initial decreases are expected to moderate only slightly by 1995 (see Table I). Total domestic drilling activity is expected to drop an average of 17% in 1986 compared to levels expected under current tax laws. Drilling activity, on average, is expected to remain 17% below base forecast levels in 1990, but the decline moderates somewhat to 13.8% below base levels, on average, in 1995. As Table I shows, estimates of the drilling decline ranged from a low of 5% to a high of 28% in 1986, with the range of estimates narrowing somewhat in the latter years.

Exploratory drilling activity is expected to decline slightly more than total (and, by implication, development) drilling activity over the outlook period. On average, exploratory drilling is expected to be 20% lower in 1986, about 19% lower in 1990, and almost 15% lower in 1995 than it otherwise would be as a result of the Treasury's proposals. However, some estimates showed as much as a 40% decline in exploratory drilling in 1986, a 33% decrease in 1990, and a 23% lower rate of drilling in 1995.

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*In some cases, the respondents provided a range of possible changes in the variable in question. When a range of estimates was provided, the midpoint of the range was used in all calculations and tables. The tables accompanying this report show the high and low endpoints of the range of estimates (or midpoints), as well as the average value.

The importance of expensing intangible drilling costs (IDC's) is illustrated by the large estimated decreases in drilling activity due to the incremental effect of repealing only this provision of the current tax law. The survey respondents estimated that exploratory drilling activity would decline almost 14% initially due to the loss of this expensing provision alone (see Table II). In 1995 exploratory drilling would still be more than 12%, to possibly as much as 23%, below levels likely under current tax law provisions. Development well drilling would not be expected to decrease as much initially as exploratory drilling; but because new discoveries drop with exploratory drilling, the decrease in development drilling accelerates over the outlook period.

Table II

Estimated Net Percentage Decrease in Drilling Activity Due to the Loss of the Expensing Provision for Intangible Drilling Costs

Forecast Year	Exploratory Drilling			Development Drilling		
	Average	High	Low	Average	High	Low
1986	13.8%	23.0%	4.0%	9.8%	13.0%	3.0%
1990	13.2	23.0	10.0	12.6	13.0	9.0
1995	12.4	23.0	5.0	14.0	15.0	11.0

The current size of the Federal Budget deficit has led many observers to believe Congress will be looking for ways to increase government revenue. To gauge the impact of one possible measure, the respondents were asked to estimate the impact of the loss of the current tax law treatment for IDC's, percentage depletion, etc., without any offsetting reduction in marginal tax rates or dividend deductibility. According to the respondents this change in the tax law would very seriously slow domestic drilling activity. Exploratory drilling activity would drop an estimated 27% in the first year after enactment, and would remain about 30% below current expectations through 1995 (see Table III). Under these conditions, total drilling activity was estimated to fall about 22% initially, with total activity remaining about 25% below levels expected under current law in 1990 and 1995.

Table III

Estimated Net Percentage Decrease in Drilling Activity Due to the Treasury's Proposal Without Offsetting Tax Rate Reductions

Forecast Year	Total Drilling			Exploratory Drilling		
	Average	High	Low	Average	High	Low
1986	21.8%	38.0%	5.0%	27.0%	40.0%	16.0%
1990	25.4	42.0	15.0	30.0	41.0	20.0
1995	24.6	42.0	10.0	29.2	42.0	15.0

Reserve Additions

Lower drilling activity due to enactment of the Treasury's proposals is expected to result in smaller annual additions to the reserves of crude oil and natural gas. On average, annual reserve additions of crude oil would be about 10% smaller than under current law in the period between enactment and 1990, and about 8% smaller between 1990 and 1995 (see Table IV). The slowing rate of decline in reserve additions parallels the pattern of exploratory drilling declines. It

Table IV

Estimated Net Percentage Decrease in Average Annual Reserve Additions Due to Possible Tax Law Changes

Forecast Year	Crude and NGL's			Natural Gas		
	Average	High	Low	Average	High	Low
Treasury Department's Proposal						
1985-1990	[illegible]	15.0%	[illegible]	15.0%	41.0%	[illegible]
1990-1995	7.8	16.0	1.0	15.4	[illegible]	5.0
Treasury's Proposal Without Offsetting Rate Reductions						
1985-1990	17.3	25.0	10.0	18.4	34.0	10.0
1990-1995	20.0	23.0	13.0	20.4	34.0	14.0

is likely that in the latter years the elimination of the windfall profits tax would help slow the drop in drilling and reserve additions. Natural gas reserve additions would decline more than for crude oil, about 15% on average initially, reflecting the fact that the elimination of the windfall profits tax would not benefit natural gas supply.

In the case without any offsetting reductions in marginal tax rates, etc., estimated reserve additions reflect the much lower drilling rates that would prevail. Average crude oil additions would be 17% lower than otherwise following enactment, with the gap widening to 20% smaller annual additions in the 1990 to 1995 period. Natural gas reserve additions follow a similar pattern of decline (Table IV).

Crude Oil and Natural Gas Production

Enactment of the Treasury's proposals is expected to have only minimal impact initially on domestic production rates for oil and gas, but because drilling activity declines substantially, the size of the production decrease increases over the outlook period. As Table V

Table V

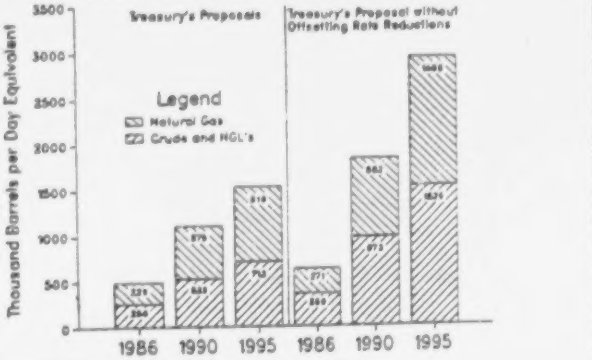
Estimated Percentage Decrease in Petroleum Production Due to the Treasury Department's Proposals

Forecast Year	Crude and NGL's			Natural Gas		
	Average	High	Low	Average	High	Low
1986	2.5%	7.0%	0.0%	2.8%	6.0%	0.0%
1990	5.4	10.0	3.0	6.8	16.0	3.0
1995	8.4	14.0	5.0	10.2	18.0	5.0

shows, the average estimated decrease in production for crude oil is 2.5% in 1986, while natural gas production is expected to decline 2.8% in 1986 compared to the base forecast levels. These declines represent a loss of about 500 thousand barrels per day of oil equivalent production (See Exhibit II and Table VI).

Exhibit II

Average Estimated Petroleum Production Lost Due to Possible Tax Law Changes



Source: Base forecast; DOE/EIA--Annual Energy Outlook 1984 and API survey of Major Oil Company Forecasts

Natural gas production would decline slightly more, in percentage terms, than oil production over the outlook period as a result of the Treasury's proposals. These higher decline rates for gas follow from the larger declines in gas reserve additions. Natural gas production

Table VI

Estimated Petroleum Production Decrease Due to Possible Tax Law Changes (thousand barrels per day equivalent

Forecast Year	Crude and NGL's			Natural Gas		
	Average	High	Low	Average	High	Low
Treasury Department's Proposal						
1986	256	718	0	229	500	0
1990	525	973	291	575	1,352	253
1995	712	1,187	424	816	1,440	400
Treasury's Proposal Without Offsetting Rate Reductions						
1986	359	1,025	0	271	500	0
1990	973	1,460	487	862	1,183	422
1995	1,526	2,035	848	1,408	1,920	800

in 1990 would average almost 7% less than under current law, while the average expected decline in crude oil production is 5.4%. By 1995, domestic natural gas production would average 10% less, and crude oil 8.4% less than expected under current tax law.

Petroleum production under the case of no offsetting reductions in marginal tax rates, etc., would be even lower than if the Treasury's proposals were enacted as currently written, and lower still compared to current expectations (see Table VI and Table VII). While the respondents foresaw a drop of 8% for crude oil production in 1995 under the Treasury's proposals, they estimate production would average

Table VII

Estimated Percentage Decrease in Petroleum Production Due to the Treasury's Proposal Without Offsetting Tax Rate Reductions

Forecast Year	Crude and NGL's			Natural Gas		
	Average	High	Low	Average	High	Low
1986	3.5%	10.0%	0.0%	3.3%	6.0%	0.0%
1990	10.0	15.0	5.0	10.2	14.0	5.0
1995	18.0	24.0	10.0	17.6	24.0	10.0

18% lower if reduced marginal tax rates and other offsets were not passed. In volumetric terms, total petroleum production in 1995 under these assumptions would average 2.9 million barrels per day less than under current tax law, and could fall to as much as 3.96 million less if the more pessimistic forecasts are correct (see Exhibit III).

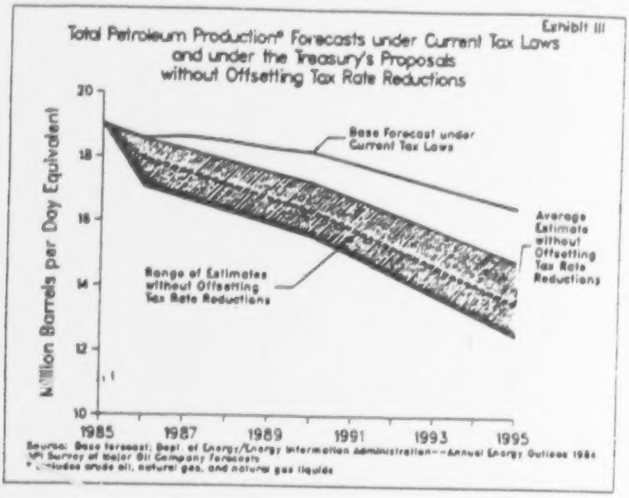


Exhibit III

Total Petroleum Production* Forecasts under Current Tax Laws and under the Treasury's Proposals without Offsetting Tax Rate Reductions

Source: Base forecast: Dept. of Energy/Energy Information Administration--Annual Energy Outlook 1984
API Survey of Major Oil Company Forecasts
* Includes crude oil, natural gas, and natural gas liquids

CONCLUSION

Although there is a great deal of uncertainty involved in comparing forecasts under different basic assumptions, this survey has shown that there is widespread consensus among major oil companies that the enactment of the Treasury Department's proposals would have serious longer-term impacts on the domestic petroleum industry. Drilling activity, and especially exploratory drilling, would be impacted almost immediately, resulting in significantly lower levels than expected under current tax laws. Lower drilling activity would soon be reflected in smaller reserve additions, and eventually lower production levels. Presumably, the reduced domestic production would result in increased petroleum imports, putting greater demand pressure on the world oil market than otherwise would be the case.

MACRO-EFFECTS QUESTIONNAIRE

IMPACT OF TREASURY TAX PROPOSALS ON OIL AND GAS DRILLING AND PRODUCTION

INSTRUCTIONS:

This questionnaire asks you to provide your estimates of the expected net percentage change in the variable due to the tax proposal from the base forecast levels under the present tax law. We are asking for your estimates of the impact on the entire industry, not on your own company. We recognize that it may not be possible to provide precise estimates in all cases, however, we would appreciate having your best estimate, even if it is a range, rather than a point estimate.

A. IMPACT OF SPECIFIC TAX PROPOSALS

1. Will the replacing of IDC's by RCRS (real cost recovery system) reduce the number of exploratory wells drilled?

   ____
   If yes, by what percent?
   In 1986 ________
   In 1990 ________
   In 1995 ________

2. Will the replacing of IDC's by RCRS reduce the number of development wells drilled?

   ____
   If yes, by what percent?
   In 1986 ________
   In 1990 ________
   In 1995 ________

B. DRILLING AND PRODUCTION UNDER THE PROPOSED TAX LAW

1. Net percentage change in petroleum liquids production rate from your base forecast level. (crude + NGL's)
   In 1986 ________
   In 1990 ________
   In 1995 ________

2. Net percentage change in natural gas production rate from base forecast level.
   In 1986 ________
   In 1990 ________
   In 1995 ________

3. Net percentage change in total drilling activity from base forecast levels.
   In 1986 ________
   In 1990 ________
   In 1995 ________
   Total exploratory wells
   In 1986 ________
   In 1990 ________
   In 1995 ________

4. Net percentage change in expected reserve additions from base forecast. (annual average)

Crude Oil and Natural Gas Liquids
In 1985-1990 ____________
In 1990-1995 ____________

Dry Natural Gas
In 1985-1990 ____________
In 1990-1995 ____________

C. DRILLING AND PRODUCTION ACTIVITY GIVEN THE PROPOSED ELIMINATION OF IDC'S, PERCENTAGE DEPLETION, ETC, BUT WITHOUT ANY REDUCTIONS IN CORPORATE TAX RATES, PAID-OUT DIVIDEND ALLOWANCES, OR CHANGES IN THE WINDFALL PROFITS TAX.

1. Net percentage change in petroleum liquids production rate from your base forecast level. (crude + NGL's)
In 1986 ____________
In 1990 ____________
In 1995 ____________

2. Net percentage change in natural gas production rate from base forecast level.
In 1986 ____________
In 1990 ____________
In 1995 ____________

3. Net percentage change in total drilling activity from base forecast levels.
In 1986 ____________
In 1990 ____________
In 1995 ____________

Total exploratory wells
In 1986 ____________
In 1990 ____________
In 1995 ____________

4. Net percentage change in expected reserve additions from base forecast. (annual average)

Crude Oil and Natural Gas Liquids
In 1985-1990 ____________
In 1990-1995 ____________

Dry Natural Gas
In 1985-1990 ____________
In 1990-1995 ____________

D. IDENTIFICATION SECTION

1. What method did you use to derive your answers? (e.g., industry or macro-economic model, extrapolation from company plan, guestimate)

   ____

2. Name of Your Company

   ____

3. Your name and phone number, in case we have any further questions.

   ____

   ____

If you have any questions or problems, please contact:

John Oshinski
(202) 682-8507

Thank you very much for your time and cooperation.

INTERSTATE OIL COMPACT
COMMISSION

Intangible Drilling Costs – Impact On Oil Exploration

50
Years of
Conservation
of Oil & Gas

1935-1985

IMPACT ON THE NATIONAL ECONOMY OF REPEALING THE EXPENSING OF INTANGIBLE DRILLING COSTS

Introduction

This study examines the impact on the United States' economy of repealing the expensing of intangible drilling costs. Under current tax law, intangible drilling costs (IDC's) are defined as expenditures that in themselves do not have salvage value and are incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and natural gas. Examples of intangible drilling costs include wages, fuel and other supplies used in preparing to drill wells, and in drilling and completing wells. In contrast, the costs of steel tubular goods, valves and other equipment with salvage value are considered tangible equipment and must be capitalized for tax purposes.

Currently, intangible drilling costs may be deducted in calculating taxable income for the year in which they are incurred. However, under a recent proposal by the Treasury Department, intangible drilling costs would be capitalized, thus requiring the tax deductions for these expenditures to be spread out over the productive life of the well. Under this proposal, which, if enacted, would be effective for costs paid or incurred on or after January 1, 1986, the effect would be to greatly reduce the amount of cash available for drilling.

Major Findings

The study found that repealing the expensing of intangible drilling costs would have the following results, on average, during the 1986-91 period:

-- drilling expenditures would be reduced by $11,213,406,500 annually;

-- 560,670 jobs would be lost due to reduced drilling;

-- 30,166 fewer oil and gas wells would be drilled each year;

-- drilling rigs operating would be reduced by 1,085 yearly;

-- additions to domestic oil and natural gas reserves would be reduced 5,607,000,000 barrels of oil equivalent (oil and natural gas, where one barrel of oil is the energy equivalent of 5,800 cubic feet of gas);

-- daily oil and natural gas production would fall by 757,494 barrels of oil equivalent;

- annual revenues from oil and gas sales would fall by $5,427,000,000;

- state tax receipts from oil and gas production would fall by $434,000,000 annually.

Background on Expensing IDC's

Under current law, oil and gas producers have the right to elect to expense IDC's as incurred or to capitalize them. They may also elect to expense only the IDC's on dry wells and to capitalize the IDC's on productive wells. If capitalized, the costs are recovered through depletion and depreciation. No investment tax credit is allowed for IDC expenditures.

Normally, oil and gas producers elect to expense IDC's in the year occurred, as this increases their after-tax cash flow. Because of the time value of money, a tax benefit allowed in year one is obviously worth more than the same tax benefit spread out over several years.

Impact on After-Tax Cash Flow

Tables One through Five calculate the total tax benefits allowed for drilling a typical well at a total cost of $590,000 under current law and under four proposed changes in the current law. This total expenditure consists of $400,000 spent on IDC's; $140,000 spent on equipment and depreciated over a ten year period; and, $50,000 spent on leasehold and depleted over the same ten year period. Note that on Table One, Current Law, the tax rate is 50% and IDC's are deducted in year one. Table Two shows that under the Kemp-Kasten proposal, the tax rate is reduced to 25%, but IDC deductions are spread over a three year period. Table Three shows that the Brandley-Gepheardt proposal sets the tax rate at 30%, but requires IDC expenditures to be depreciated over the productive life of the well, in this case assumed to be ten years. Table Four, Treasury Proposal Without Indexing, sets the tax rate at 35% and treats IDC's the same as the Bradley-Gepheardt proposal. Table Five, Treasury Proposal Including Indexing at 6% Annual Rate of Inflation, shows the same tax rate and treatment for IDC's as in Table Four, except the cost basis is adjusted each year for inflation, thus increasing the amount of the deductions allowed in years two through ten.

Compared to present law, each of the four proposed changes would reduce the tax benefits available to the producer in year one. Although most of the tax benefits in years two through ten would be somewhat higher under the four proposed changes, these increases would not be enough to restore the tax benefits available in year one under current law.

Table Six, Evaluation and Dollar Comparison of Total Tax Benefits Under the Various Flat Tax Proposals, summarizes the total tax benefits as calculated in Tables One through Five and compares the tax benefits, in dollars, of the current law to those that would be available under the four proposed changes. Note that in year one the producer's tax benefits are reduced by $192,100 to $200,300 under the four proposed changes, so the lower overall tax rates do not offset the reduced IDC deductions.

Table Seven, Evaluation and Percentage Comparison of Total Tax Benefits Under the Various Flat Tax Proposals, uses the same total tax benefit data discussed above, and shows the percentage reduction in current tax benefits under each of the four proposed changes. Note that in year one, the total tax benefit from a $590,000 drilling expenditure drops by more than 32% in each case.

Table Eight, Evaluation and Comparison of After-Tax Cash Flow Using the Total Tax Benefits Under the Various Flat Tax Proposals, assumes a producer has $590,000 of income which he uses to drill a well. The drilling expenditure generates various tax deductions under the current law and the four proposed changes, resulting in the after-tax cash flow shown in Table Eight. The largest reduction, $103,600 or 17.56%, occurs in year one under the Treasury proposal, with or without inflation indexing. Even though the Producer's cash flow would be increased by 4.32% in year two under the Treasury proposal with indexing, his tax benefits for new expenditure made that year would once again be 17.56% lower than under current law. So, under the Treasury proposal, the after-tax cash flow of the producer who drills new wells each year would never catch up with the amount he could expect under current law.

Impact on National Economy

The impact on the national economy of repealing the expensing of intangible drilling costs is assessed by taking the effect on the producer's after tax cash flow from an average well, as analyzed above, and applying the results to overall petroleum industry figures.

Table Nine, National Analysis of the Impact of the Proposed Tax Treatment on Intangible Drilling Costs on Drilling Expenditures, Wells Drilled, Employment and Reserves Found - 1986-1991, shows the historical expenditures for domestic drilling for 1980 through 1983, as reported by the Joint Association Survey. Under current law, 1986-91 drilling expenditures are forecast to remain at the 1983 level. Presently, approximately 38% of the funds available for drilling is obtained from outside the petroleum industry from sources such as investors and bank loans. Approximately 62% of the funds available for drilling is generated within the industry from oil and gas revenues.

For an investor, the ability to expense two-thirds or more of his investment in oil and gas drilling during the first year is a major incentive for putting his dollars at risk. Falling oil and natural gas prices during the past two years have already made it more difficult to raise outside capital, through either debt or equity means. If a worthwhile yet high risk investment has no better tax treatment than a safe investment, the investor may as well play it safe. Thus, third party funding is forecast to drop by one-half in 1986 under the Treasury proposal.

The economic analysis forecasts that, if the Treasury proposal were enacted, drilling expenditures in 1986 would drop by one-third, or $9,941,000,000. The reduction would be due to uncertainty within the industry and reduced funding from outside investors and lenders. After 1986, industry expenditures on domestic drilling are forecast to remain at two-thirds of 1984 levels, adjusted by the percentage change in after-tax cash flow, as calculated on Table Eight for the Treasury proposal.

Economic research has found that a reduction in drilling expenditures of $1,000,000 results in the loss of fifty jobs. Therefore, the 1986-1991 yearly average of $11,213,000,000 in reduced drilling expenditures would result in 560,670 jobs lost.

At an average cost of $371,721 per well, these reduced drilling expenditures would mean that 30,196 fewer oil and gas wells would be drilled each year, and 1,085 fewer rigs would be running annually. Based on an average finding cost of $12 per barrel of oil equivalent, reserve additions would be reduced by 5,607,000,000 barrels of oil equivalent during the six year period.

Because of the reduced drilling, daily production would drop by an average of 757,494 barrels of oil equivalent. At an average price of $19.63 per barrel of oil equivalent, the reduced production would result in an average annual reduction in oil and gas sales of $5,427,000,000. Revenues from state production taxes, at an average tax rate of 8% would drop $434,000,000 annually.

The impact on the United States economy is illustrated by Charts One through Seven, each headed U.S. Impact of IDC Tax Proposal. Chart One, Comparison of Drilling Expenditures Yearly, shows historical drilling expendituress from 1980 through 1984, then compares the forecast of domestic drilling expenditures under current law to the forecast for expenditures under the Treasury Proposal. The remaining charts show the 1986-1991 annual impact on drilling expenditures, employment, wells drilled, rigs in operation, reserves added, and daily production.

Current Law

CURRENT LAW

Year	IDC	Depreciation	Depletion	Total Deductions	Tax Benefit At 50% Rate	ITC	Total Tax Benefits
1	400,000	21,000	7,800	428,800	214,400	11,200	225,600
2	0	30,800	11,700	42,500	21,300	0	21,300
3	0	29,400	8,300	37,700	18,900	0	18,900
4	0	29,400	7,300	36,700	18,400	0	18,400
5	0	29,400	6,300	35,700	17,900	0	17,900
6	0	0	4,700	4,700	2,400	0	2,400
7	0	0	2,200	2,200	1,100	0	1,100
8	0	0	1,100	1,100	600	0	600
9	0	0	400	400	200	0	200
10	0	0	200	200	100	0	100
Total	400,000	140,000	50,060	590,000	295,300	11,200	306,500
			Net After Tax Present Value at			12.00%	255,800

IDC = 400,000
Equipment = 140,000
Leasehold = 50,000
Tax Rate = 50.00%

KEMP - KASTEN

Year	IDC	Depreciation	Depletion	Total Deductions	Tax Benefit At 25% Rate	ITC	Total Tax Benefits
1	100,000	21,000	12,500	133,500	33,400	0	33,400
2	152,000	30,800	19,000	201,800	50,500	0	50,500
3	148,000	29,400	18,500	195,900	49,000	0	49,000
4	0	29,400	0	29,400	7,400	0	7,400
5	0	29,400	0	29,400	7,400	0	7,400
6	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0
Total	400,000	140,000	50,000	590,000	147,700	0	147,700
			Net After Tax Present Value at			12.00%	113,900

IDC = 400,000
Equipment = 140,000
Leasehold = 50,000
Tax Rate = 25.00%

BRADLEY - GEPHEARDT

AMENDED

BRADLEY-GEPHEARDT

Year	IDC	Depreciation	Depletion	Total Deductions	Tax Benefit At 30% Rate	ITC	Total Tax Benefits
1	50,000	28,000	6,300	84,300	25,300	0	25,300
2	87,500	44,800	10,900	143,200	43,000	0	43,000
3	65,600	26,900	8,200	100,700	30,200	0	30,200
4	49,200	16,100	6,200	71,500	21,500	0	21,500
5	36,900	9,700	4,600	51,200	15,400	0	15,400
6	27,700	5,800	3,500	37,000	11,100	0	11,100
7	20,800	3,500	2,600	26,900	8,100	0	8,100
8	15,600	2,100	1,900	19,600	5,900	0	5,900
9	11,700	1,200	1,500	14,400	4,300	0	4,300
10	35,000	1,900	4,300	41,200	12,400	0	12,400
Total	400,000	140,000	50,000	590,000	177,200	0	177,200

Net After Tax Present Value at 12.00% 118,000

AMENDED

IDC = 400,000
Equipment = 140,000
Leasehold = 50,000
Tax Rate = 30.00%

IDLTHP

SUMMARY

Impact of Federal Tax Proposals on Intangible Drilling Costs

1986 - 1991

INTERSTATE OIL COMPACT COMMISSION

AVERAGE IMPACT 1986 - 1991	NATIONALLY	TEXAS	OKLAHOMA	
REDUCTION IN ANNUAL DRILLING	$12,609,000,000	$3,948,000,000	$1,857,000,000	Per year
REDUCTION IN JOBS	630,443	197,399	92,841	Per year
REDUCTION IN NUMBER OF WELLS DRILLED**	203,521	68,250	24,880	Wells
REDUCTION IN DRILLING RIGS	1,219	461	159	Per year
REDUCTION IN OIL AND GAS RESERVES ADDED**	6,304,000,000	1,974,000,000	928,000,000	Boe
REDUCTION IN OIL AND GAS PRODUCTION	838,293	262,479	123,450	Boe per day
REDUCTION IN ANNUAL OIL AND GAS REVENUES	$6,006,000,000	$1,881,000,000	$885,000,000	Per year
REDUCTION IN SEVERANCE TAX PAYMENTS	$360,000,000	$114,000,000	$63,000,000	Per year

** Wells drilled and reserves are cumulative 1986 thru 1991.
All others are averages per year.

Basis:

- Industry expenditures are reduced by one-third in 1986 due to uncertainty and reduced third party funding.
- Third party funding is reduced by one-half in 1986 due to uncertainty in in tax treatment.
- After 1986 industry expenditures remain at two-thirds of 1984 levels + or - cash flow effects from accelerated tax payments.
- After 1986 third party funding remains at two-thirds of 1984 levis + or - cash flow effects from accelerated tax payments.
- Reserves are added at a $12.00 per barrel oil of equivalent from 1986 - 1991.
- The 1986 - 1991 average wellhead price of oil and gas combined is $19.63 per barrel of oil equivalent.
- A reduction in drilling expenditures of one million dollars results in a

January 1985

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IDCEFFECT

INTERSTATE OIL COMPACT COMMISSION

NATIONAL
ANALYSIS OF THE IMPACT OF THE PROPOSED TAX TREATMENT
OF INTANGIBLE DRILLLING COSTS ON DRILLING EXPENDITURES,
WELLS DRILLED, EMPLOYMENT & RESERVES FOUND - 1986- 1991

1984 DRILLING RIGS	2248
1983 WELL COST	$371,721
GPT TAX RATE	6.00%

	CURRENT LAW		TREASURY PROPOSAL								
YEAR	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	I.D.C. DRILLING EXPENDITURES ($mm)	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	I.D.C. DRILLING EXPENDITURES ($mm)	REDUCTION IN TOTAL CASH AVAILABLE FOR DRILLING ($mm)	REDUCTION IN DRILLING EXPENDITURES ($mm)	REDUCTION IN EMPLOYMENT (JOBS	REDUCTION IN TOTAL WELLS DRILLED	REDUCTION IN DRILLING RIG ACTIVITY	REDUCTION IN RESERVES ADDED (mmBOE)	REDUCTION IN DAILY PRODUCTION (BOE/DAY)
80	$22,800	$22,800	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
81	$36,665	$36,665	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
82	$39,428	$39,428	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
83	$25,105	$25,105	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
84	$25,105	$25,105	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
86	$25,105	$25,105	$15,163	$15,163	$9,941	$9,941	497,066	26,744	890	828	79,440
87	$25,105	$25,105	$10,308	$10,308	$14,797	$14,797	739,827	39,805	1,325	1,233	345,208
88	$25,105	$25,105	$12,508	$12,508	$12,596	$12,596	629,820	33,887	1,128	1,050	722,190
89	$25,105	$25,105	$12,026	$12,026	$13,079	$13,079	653,927	35,184	1,171	1,090	1,052,693
90	$25,105	$25,105	$12,393	$12,393	$12,712	$12,712	635,592	34,197	1,138	1,059	1,307,298
91	$25,105	$25,105	$12,576	$12,576	$12,529	$12,529	626,425	33,704	1,122	1,044	1,522,928
TOTAL	$150,627	$150,627	$74,974	$74,974	$75,653	$75,653	n.a.	203,521	n.a.	6,304	n.a.
AVERAGE	$25,105	$25,105	$12,496	$12,496	$12,609	$12,609	630,443	33,920	1,129	1,051	838,293

AVERAGE IMPACT 1986-91:

REDUCTION IN DRILLING EXPENDITURES YEARLY	$12,609 MILLION
REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:	630,443 JOBS
REDUCTION IN NUMBER OF WELLS DRILLED YEARLY	33,920 WELLS
REDUCTION IN DRILLING RIG RUNNING YEARLY	1,129 RIGS
REDUCTION IN RESERVES ADDED AT $12.00 PER BOE:	6,304 mmBOE
REDUCTION IN DAILY OIL AND GAS PRODUCTION:	838,293 BOE/DAY
REDUCTION IN OIL AND GAS SALES:	$6,006 MILLION
REDUCTION IN STATE GPT COLLECTIONS:	$360 MILLION

ASSUMPTIONS:

INDUSTRY EXPENDITURES ARE REDUCED BY ONE-THIRD IN 1986 DUE TO UNCERTAINTY AND REDUCED THIRD PARTY FUNDING
THIRD PARTY FUNDING IS REDUCED BY ONE-HALF IN 1986 DUE TO UNCERTAINTY IN TAX TREATMENT
AFTER 1986 INDUSTRY EXPENDITURES REMAIN AT TWO-THIRDS OF 1984 LEVELS + OR - REDUCED CASH FLOW FROM ACCELERATED TAX PAYMENTS.
AFTER 1986 THIRD PARTY FUNDING REMAIN AT ONE-HALF OF 1984 LEVELS + OR - REDUCED CASH FLOW FROM ACCELERATED TAX PAYMENTS.
1986 AVERAGE WELLHEAD PRICE WAS $19.50 BOE.
A REDUCTION IN DRILLING EXPENDITURES OF ONE MILLION DOLLARS RESULTS IN A LOSS OF 50 JOBS.

Preliminary Evaluation
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January 8 1985

BENEFITP

INTERSTATE OIL COMPACT COMMISSION

EVALUATION AND COMPARISION OF IDC TOTAL TAX BENEFITS UNDER THE VARIOUS FLAT TAX PROPOSALS

	TOTAL TAX BENEFIT					PERCENT REDUCTION IN CASH AVAILABLE TO SPEND BASED ON $600,000 INITIAL EXPENDITURE			
YEAR	CURRENT LAW 50%	KEMP & KASTEN 25%	BRADLEY & GEPHEARDT 30%	TREASURY WITHOUT INDEXING 35%	TREASURY WITH INDEXING 35%	KEMP & KASTEN 25%	BRADLEY & GEPHEARDT 30%	TREASURY WITHOUT INDEXING 35%	TREASURY WITH INDEXING 35%
1	$225,600	$33,400	$25,300	$33,500	$33,500	-32.03%	-33.38%	-32.02%	-32.02%
2	$21,300	$50,500	$43,000	$44,200	$46,800	4.87%	3.62%	3.82%	4.25%
3	$18,900	$49,000	$30,200	$32,000	$35,900	5.02%	1.88%	2.18%	2.83%
4	$18,400	$7,400	$21,500	$27,900	$33,200	-1.83%	0.52%	1.58%	2.47%
5	$17,900	$7,400	$15,400	$23,700	$29,900	-1.75%	-0.42%	0.97%	2.00%
6	$2,400	$0	$11,100	$18,100	$24,200	-0.40%	1.45%	2.62%	3.63%
7	$1,100	$0	$8,100	$9,600	$13,500	-0.18%	1.17%	1.42%	2.07%
8	$600	$0	$5,900	$5,600	$8,400	-0.10%	0.88%	0.83%	1.30%
9	$200	$0	$4,300	$3,200	$5,000	-0.03%	0.68%	0.50%	0.80%
10	$100	$0	$12,400	$8,900	$15,000	-0.02%	2.05%	1.47%	2.48%
TOTAL	$306,500	$147,700	$177,200	$206,700	$245,400	-26.47%	-21.55%	-16.63%	-10.18%
NPV @ 12.00%	$255,772	$113,859	$117,980	$138,896	$159,230				

BASIS:

TAX RATE:	50%	25%	30%	35%	35%	25%	30%	35%	35%

IDC: $400,000
EQUIPMENT: $140,000
LEASEHOLD: $50,000

BENEFIT

INTERSTATE OIL COMPACT COMMISSION

EVALUATION AND COMPARISION
OF IDC TOTAL TAX BENEFITS UNDER
THE VARIOUS FLAT TAX PROPOSALS

January 1985

	TOTAL TAX BENEFIT					COMPARISION OF TAX BENEFITS WITH CURRENT LAW			
YEAR	CURRENT LAW 50%	KEMP & KASTEN 25%	BRADLEY & GEPHEARDT 30%	TREASURY WITHOUT INDEXING 35%	TREASURY WITH INDEXING 35%	KEMP & KASTEN 25%	BRADLEY & GEPHEARDT 30%	TREASURY WITHOUT INDEXING 35%	TREASURY WITH INDEXING 35%
1	$225,600	$33,400	$25,300	$33,500	$33,500	($192,200)	($200,300)	($192,100)	($192,100)
2	$21,300	$50,500	$43,000	$44,200	$46,800	$29,200	$21,700	$22,900	$25,500
3	$18,900	$49,000	$30,200	$32,000	$35,900	$30,100	$11,300	$13,100	$17,000
4	$18,400	$7,400	$21,500	$27,900	$33,200	($11,000)	$3,100	$9,500	$14,800
5	$17,900	$7,400	$15,400	$23,700	$29,900	($10,500)	($2,500)	$5,800	$12,000
6	$2,400	$0	$11,100	$18,100	$24,200	($2,400)	$8,700	$15,700	$21,800
7	$1,100	$0	$8,100	$9,600	$13,500	($1,100)	$7,000	$8,500	$12,400
8	$600	$0	$5,900	$5,600	$8,400	($600)	$5,300	$5,000	$7,800
9	$200	$0	$4,300	$3,200	$5,000	($200)	$4,100	$3,000	$4,800
10	$100	$0	$12,400	$8,900	$15,000	($100)	$12,300	$8,800	$14,900
TOTAL	$306,500	$147,700	$177,200	$206,700	$245,400	($158,800)	($129,300)	($99,800)	($61,100)
NPV @ 12.00%	$255,772	$113,859	$117,980	$138,896	$159,230	($141,913)	($137,792)	($116,876)	($96,542)
BASIS: TAX RATE:	50%	25%	30%	35%	35%	25%	30%	35%	35%

IDC: $400,000
EQUIPMENT: $140,000
LEASEHOLD: $50,000

Treasury Proposal

TREASURY PROPOSAL WITHOUT INDEXING

Year	IDC	Depreciation	Depletion	Total Deductions	Tax Benefit At 35% Rate	ITC	Total Tax Benefits
1	62,600	25,200	7,800	95,600	33,500	0	33,500
2	93,900	20,700	11,700	126,300	44,200	0	44,200
3	66,100	16,900	8,300	91,300	32,000	0	32,000
4	58,400	13,900	7,300	79,600	27,900	0	27,900
5	50,100	11,400	6,300	67,800	23,700	0	23,700
6	37,600	9,300	4,700	51,600	18,100	0	18,100
7	17,400	7,700	2,200	27,300	9,600	0	9,600
8	8,700	6,300	1,100	16,100	5,600	0	5,600
9	3,500	5,100	400	9,000	3,200	0	3,200
10	1,700	23,500	200	25,400	8,900	0	8,900
Total	400,000	140,000	50,000	590,000	206,700	0	206,700
			Net After Tax Present Value at			12.00%	138,900

IDC = 400,000
Equipment = 140,000
Leasehold = 50,000
Tax Rate = 35.00%

Treasury Proposal

TREASURY PROPOSAL INCLUDING INDEXING AT 6% ANNUAL RATE OF INFLATION

Year	IDC	Depreciation	Depletion	Total Deductions	Tax Benefit At 35% Rate	ITC	Total Tax Benefits
1	62,600	25,200	7,800	95,600	33,500	0	33,500
2	99,500	21,900	12,400	133,800	46,800	0	46,800
3	74,300	19,000	9,300	102,600	35,900	0	35,900
4	69,600	16,500	8,700	94,800	33,200	0	33,200
5	63,200	14,400	7,900	85,500	29,900	0	29,900
6	50,300	12,500	6,300	69,100	24,200	0	24,200
7	24,700	10,900	3,100	38,700	13,500	0	13,500
8	13,100	9,400	1,600	24,100	8,400	0	8,400
9	5,500	8,200	700	14,400	5,000	0	5,000
10	2,900	39,600	400	42,900	15,000	0	15,000
Total	465,700	177,600	58,200	701,500	245,400	0	245,400
			Net After Tax Present Value at			12.00%	155,200

	Original
IDC =	400,000
Equipment =	140,000
Leasehold =	50,000
Tax Rate =	35.00%

Year	IDC/Lease Property	L & W Property	Index
1	0.157	0.100	1.00
2	0.278	0.100	1.06
3	0.271	0.100	1.06
4	0.329	0.100	1.06
5	0.421	0.100	1.06
6	0.543	0.100	1.06
7	0.556	0.100	1.06
8	0.625	0.100	1.06
9	0.667	0.100	1.06
10	1.000	1.000	1.06

INTERSTATE OIL COMPACT COMMISSION

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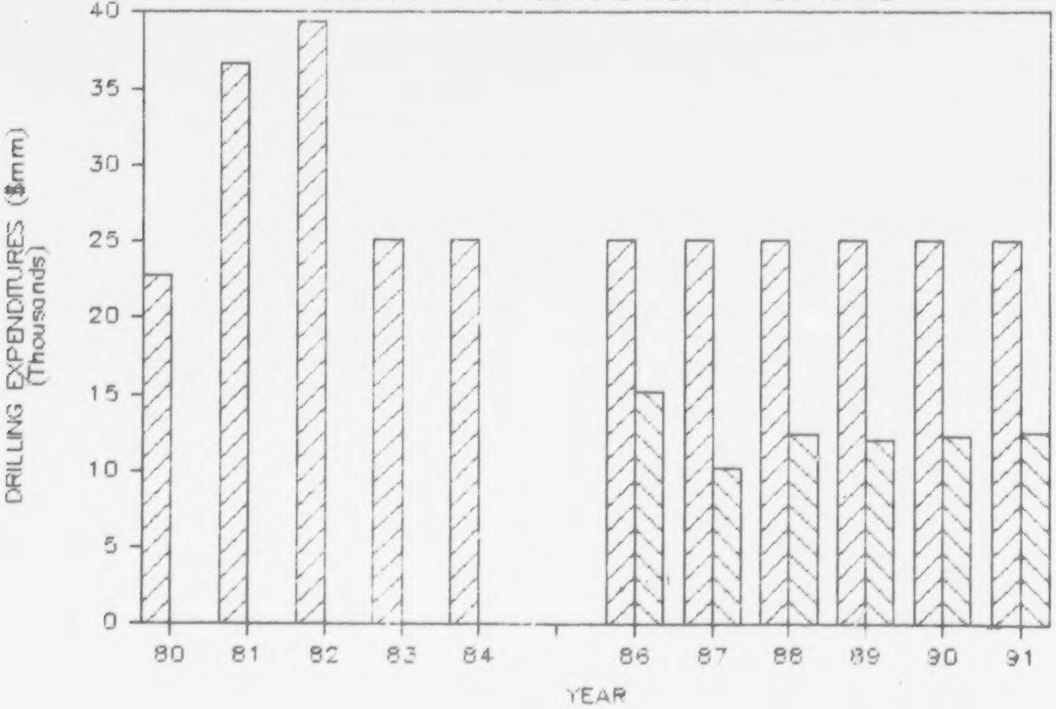
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DRILLING EXPENDITURES YEARLY



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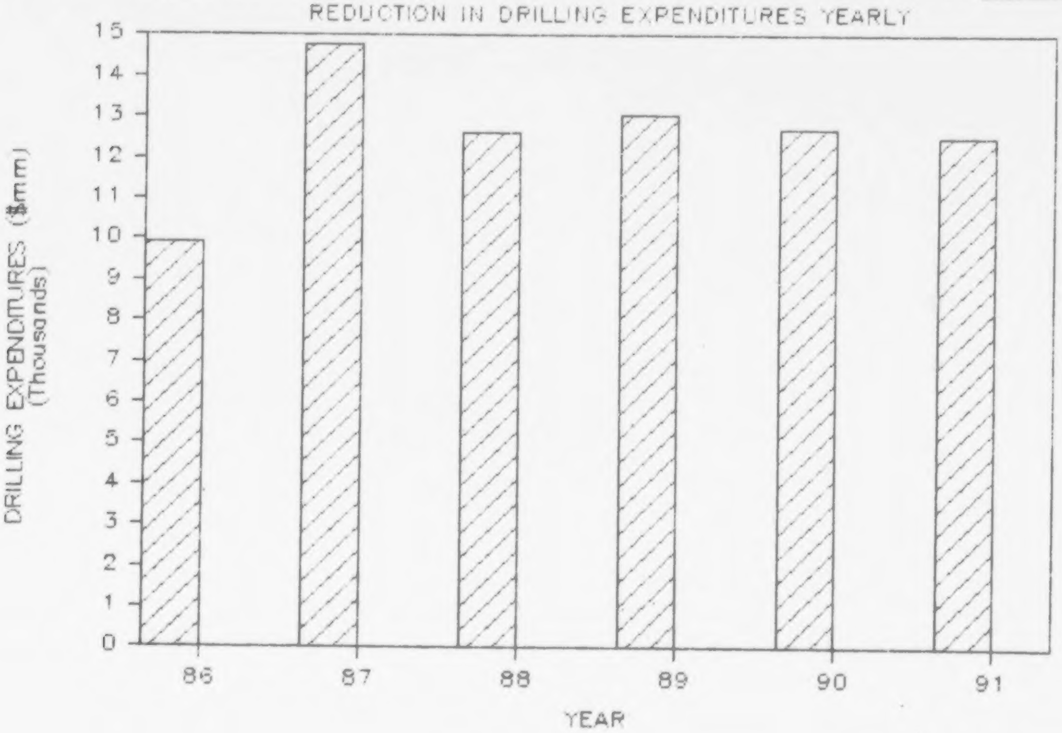
U.S. IMPACT OF IDC TAX PROPOSAL



INTERSTATE OIL COMPACT COMMISSION

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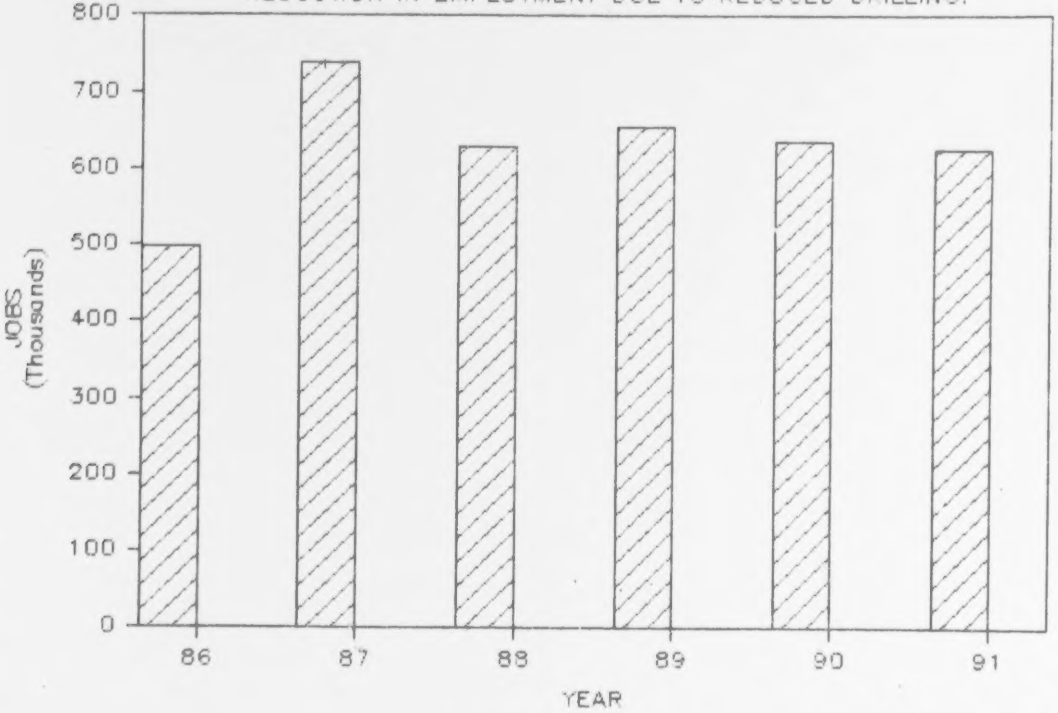
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:



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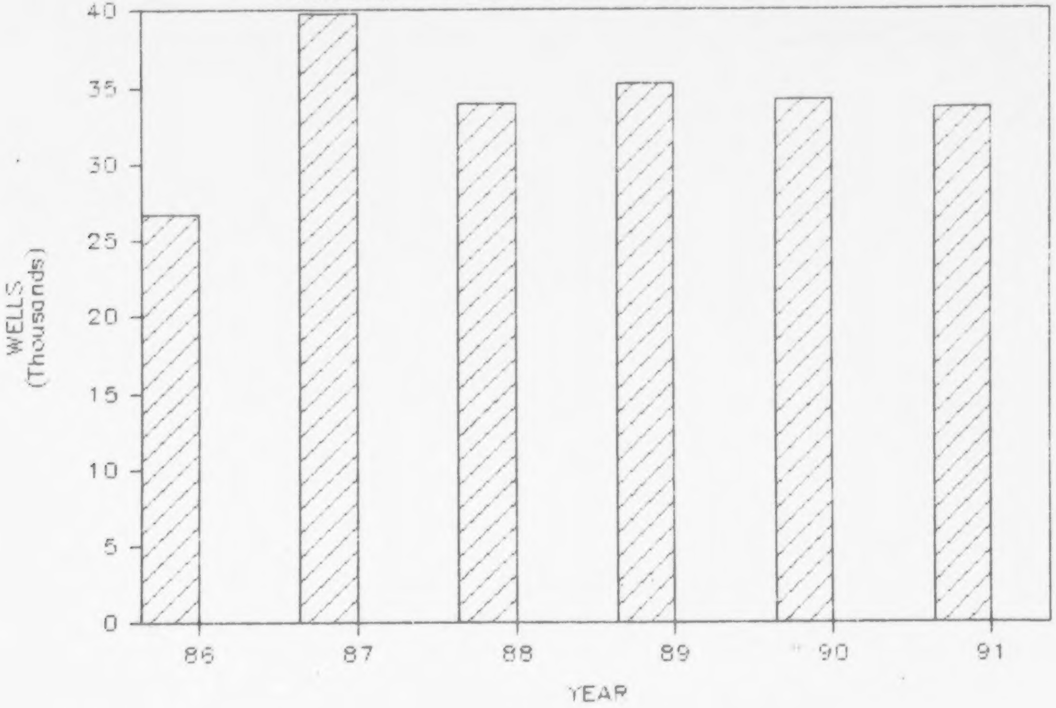
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN NUMBER OF WELLS DRILLED YEARLY



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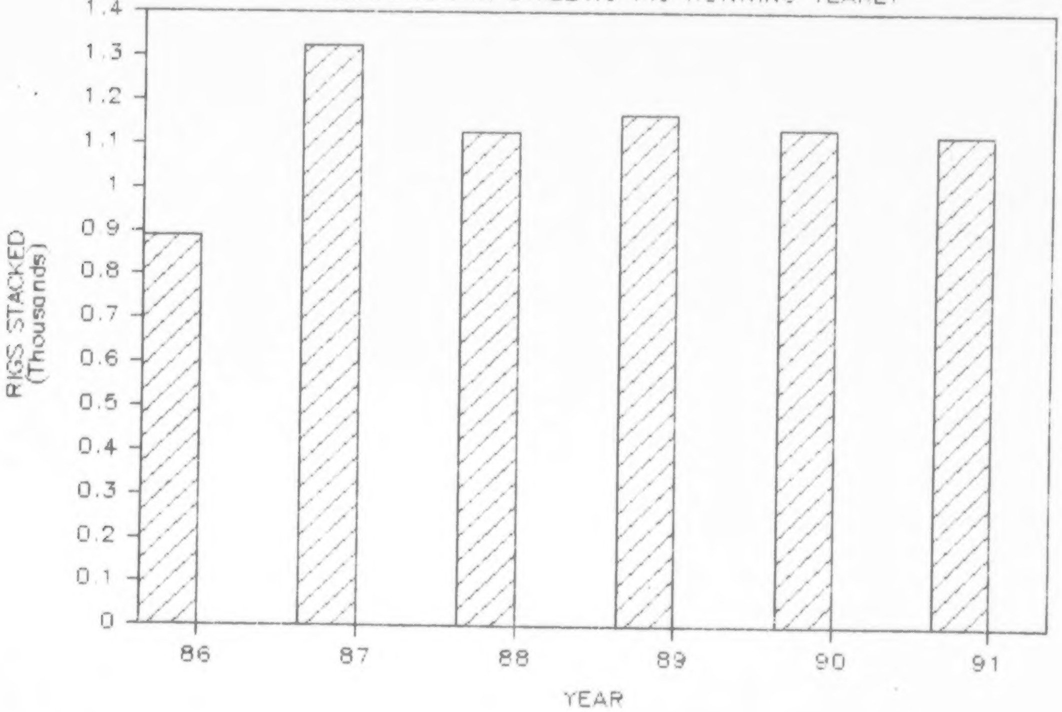
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DRILLING RIG RUNNING YEARLY



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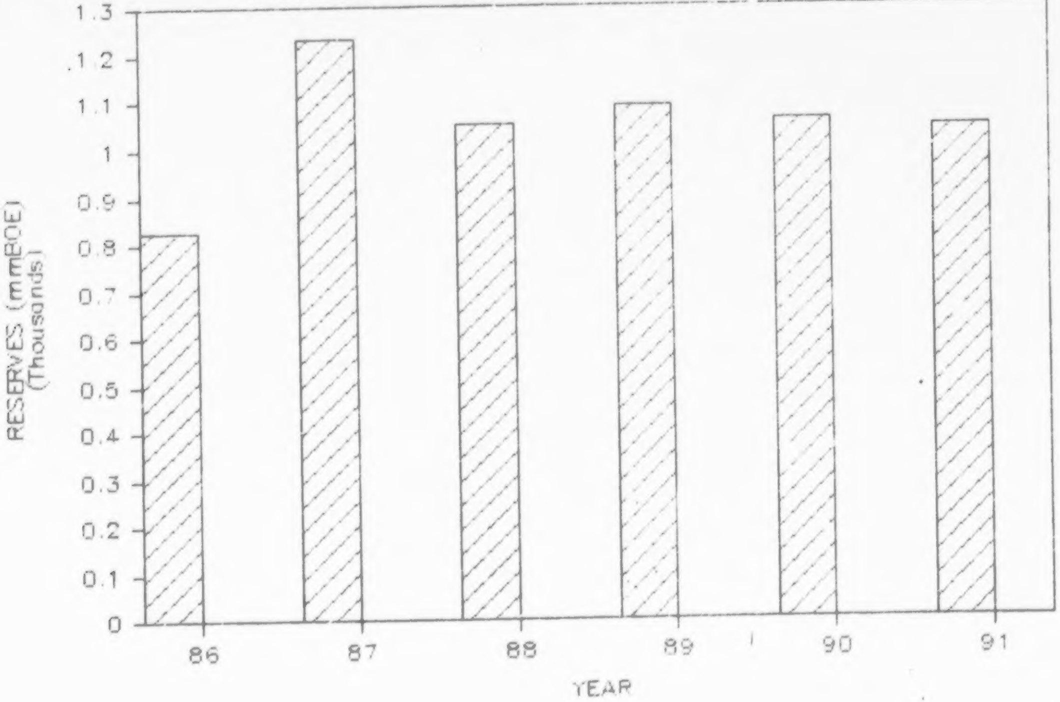
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN RESERVES ADDED A $12.00 PER BOE:



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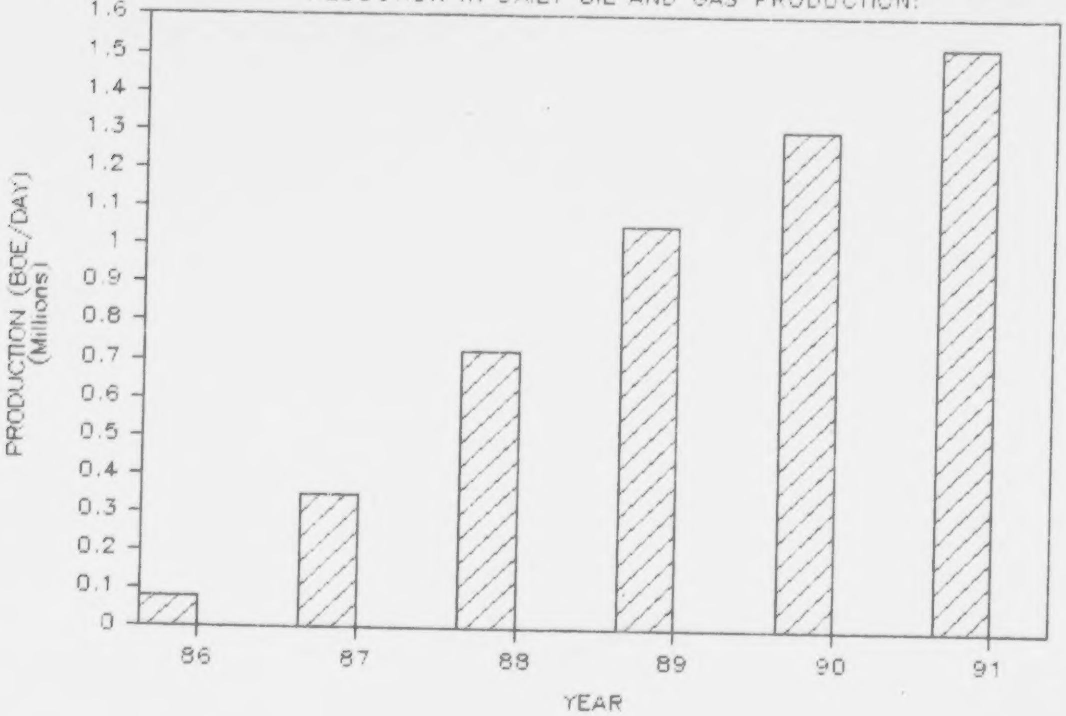
U.S. IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DAILY OIL AND GAS PRODUCTION:



IOCC/FEL

TEXAS

(L&P)
ANALYSIS OF THE IMPACT OF THE PROPOSED TAX TREATMENT
OF INTANGIBLE DRILLLING COSTS ON DRILLING EXPENDITURES,
WELLS DRILLED, EMPLOYMENT & RESERVES FOUND - 1986- 1991

INTERSTATE OIL COMPACT COMMISSION

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1984 DRILLING RIGS	917
1983 WELL COST	$347,174
GPT TAX RATE	6.05%

YEAR	CURRENT LAW: TOTAL CASH AVAILABLE FOR DRILLING ($mm)	CURRENT LAW: I.D.C. DRILLING EXPENDITURES ($mm)	TREASURY PROPOSAL: TOTAL CASH AVAILABLE FOR DRILLING ($mm)	TREASURY PROPOSAL: I.D.C. DRILLING EXPENDITURES ($mm)	REDUCTION IN TOTAL CASH AVAILABLE FOR DRILLING ($mm)	REDUCTION IN DRILLING EXPENDITURES ($mm)	REDUCTION IN EMPLOYMENT (JOBS	REDUCTION IN TOTAL WELLS DRILLED	REDUCTION IN DRILLING RIG ACTIVITY	REDUCTION IN RESERVES ADDED (mmBOE)	REDUCTION IN DAILY PRODUCTION (BOE/DAY)
80	$7,088	$7,088	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
81	$12,011	$12,011	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
82	$12,013	$12,013	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
83	$7,861	$7,861	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
84	$7,861	$7,861	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
86	$7,861	$7,861	$4,748	$4,748	$3,113	$3,113	155,637	8,966	363	259	24,874
87	$7,861	$7,861	$3,228	$3,228	$4,633	$4,633	231,649	13,345	540	386	108,089
88	$7,861	$7,861	$3,916	$3,916	$3,944	$3,944	197,204	11,361	460	329	226,126
89	$7,861	$7,861	$3,765	$3,765	$4,095	$4,095	204,752	11,795	478	341	329,611
90	$7,861	$7,861	$3,880	$3,880	$3,980	$3,980	199,012	11,465	464	332	409,331
91	$7,861	$7,861	$3,938	$3,938	$3,923	$3,923	196,141	11,299	458	327	476,847
TOTAL	$47,163	$47,163	$23,475	$23,475	$23,688	$23,688	n.a.	68,231	n.a.	1,974	n.a.
AVERAGE	$7,861	$7,861	$3,913	$3,913	$3,948	$3,948	197,399	11,372	461	329	262,479

AVERAGE IMPACT 1986-91:

REDUCTION IN DRILLING EXPENDITURES YEARLY	$3,948 MILLION
REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:	197,399 JOBS
REDUCTION IN NUMBER OF WELLS DRILLED YEARLY	11,372 WELLS
REDUCTION IN DRILLING RIG RUNNING YEARLY	461 RIGS
REDUCTION IN RESERVES ADDED AT $12.00 PER BOE:	1,974 mmBOE
REDUCTION IN DAILY OIL AND GAS PRODUCTION:	262,479 BOE/DAY
REDUCTION IN OIL AND GAS SALES:	$1,881 MILLION
REDUCTION IN STATE GPT COLLECTIONS:	$114 MILLION

ASSUMPTIONS:

INDUSTRY EXPENDITURES ARE REDUCED BY ONE-THIRD IN 1986 DUE TO UNCERTAINTY AND REDUCED THIRD PARTY FUNDING
THIRD PARTY FUNDING IS REDUCED BY ONE-HALF IN 1986 DUE TO UNCERTAINTY IN TAX TREATMENT
AFTER 1986 INDUSTRY EXPENDITURES REMAIN AT TWO-THIRDS OF 1984 LEVELS + OR - REDUCED CASH FLOW FROM ACCELERATED TAX PAYMENTS.
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1996 AVERAGE WELLHEAD PRICE WAS $19.63/BOE.
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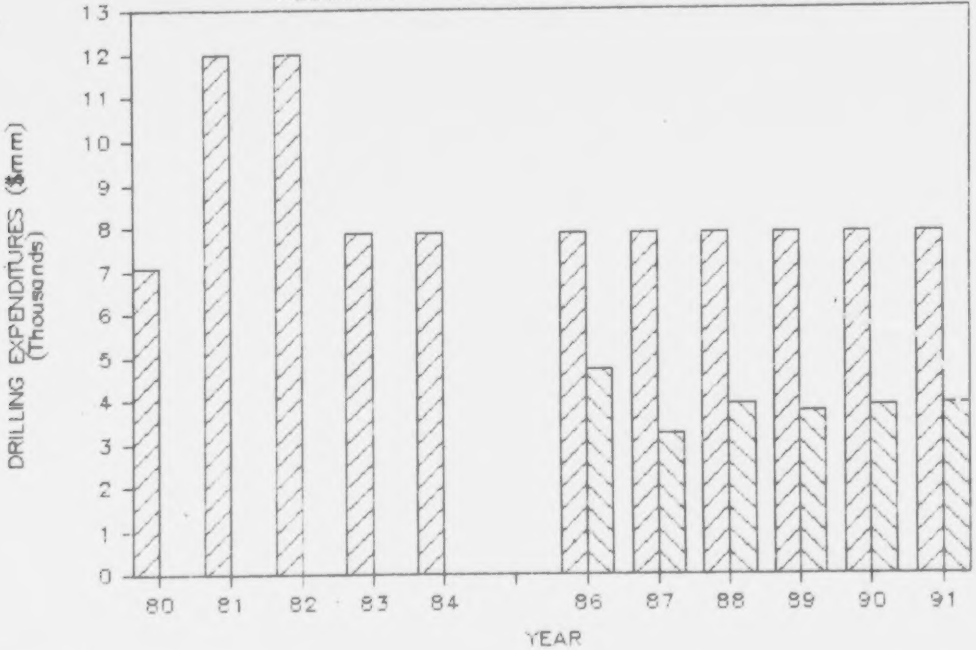
TEXAS IMPACT OF IDC TAX PROPOSAL


REDUCTION IN DRILLING EXPENDITURES YEARLY

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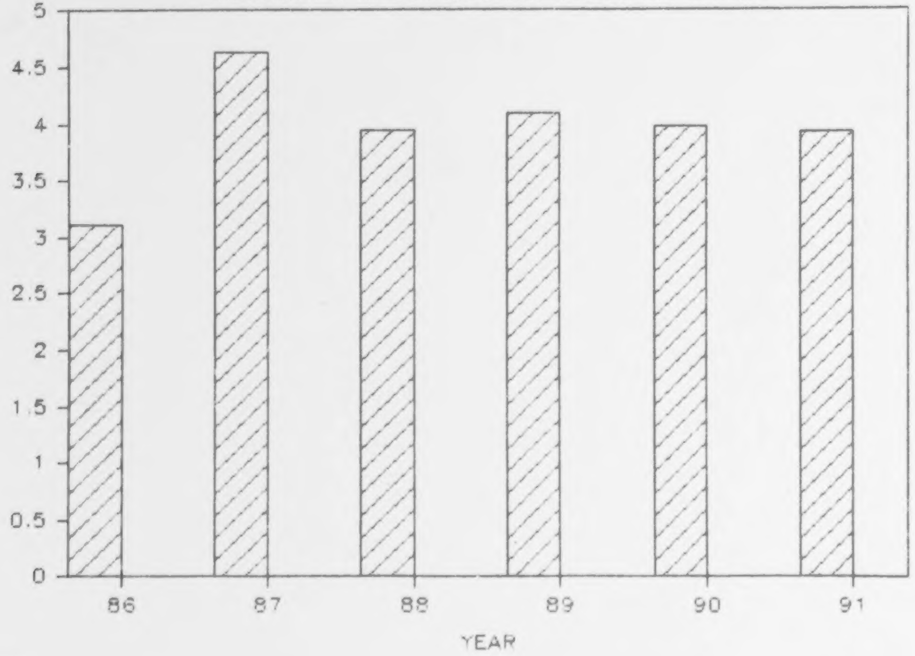

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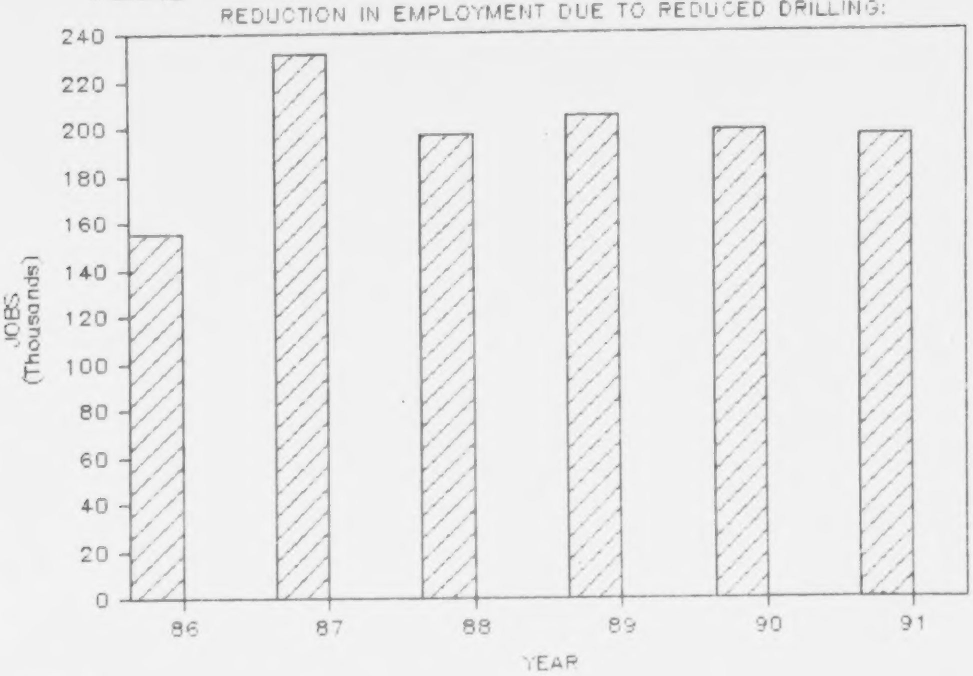
TEXAS IMPACT OF IDC TAX PROPOSAL



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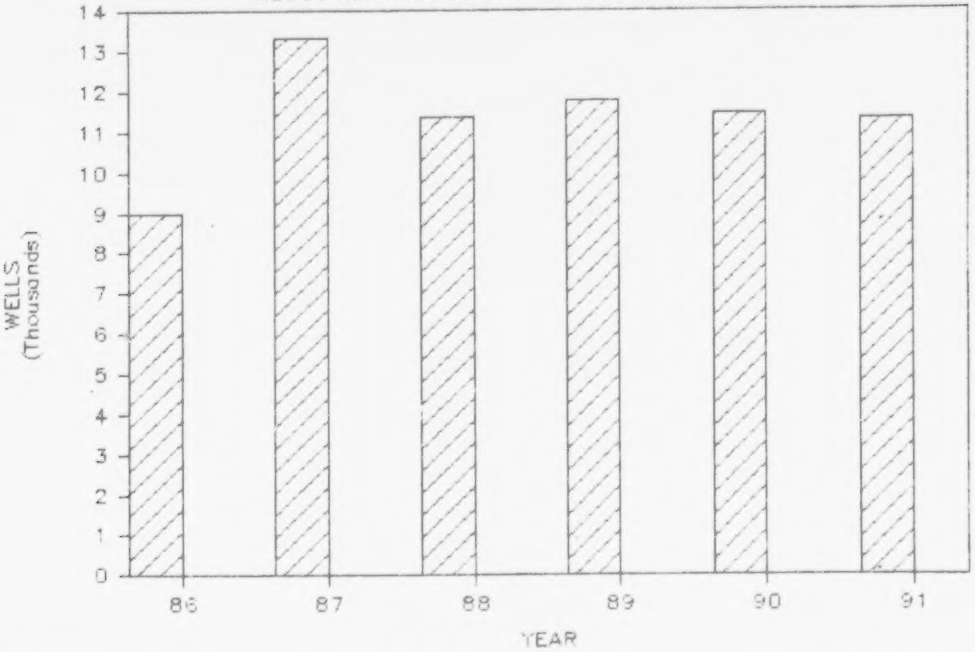
INTERSTATE OIL COMPACT COMMISSION

TEXAS IMPACT OF IDC TAX PROPOSAL

REDUCTION IN NUMBER OF WELLS DRILLED YEARLY



Preliminary Evaluation
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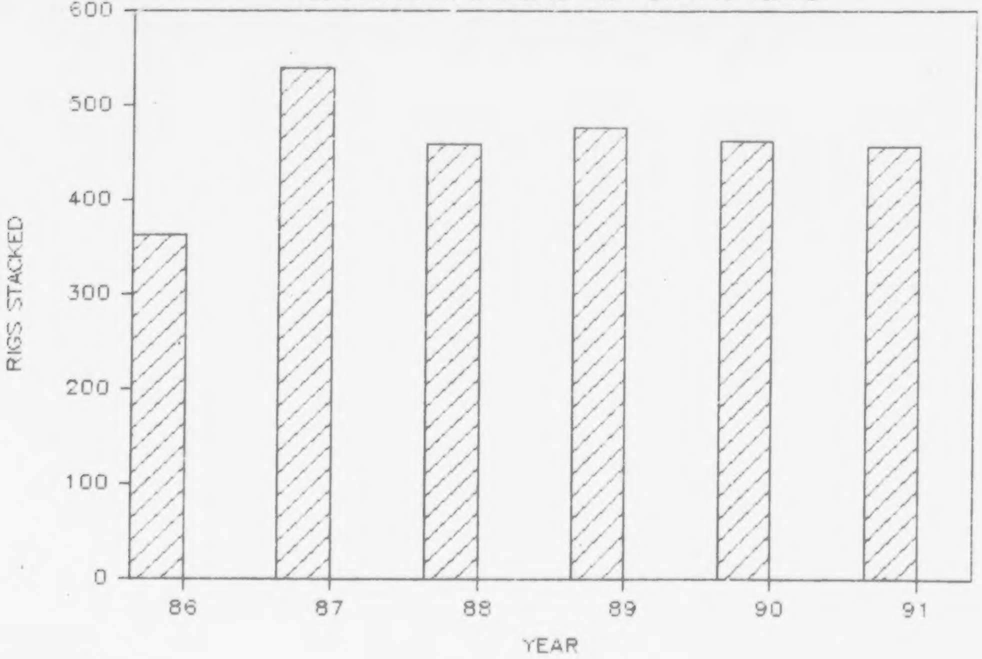
Proposal on State Resources
Economy and Tax Revenues
January 8 1985

Interstate Oil Compact Commission

January 1985

TEXAS IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DRILLING RIG RUNNING YEARLY



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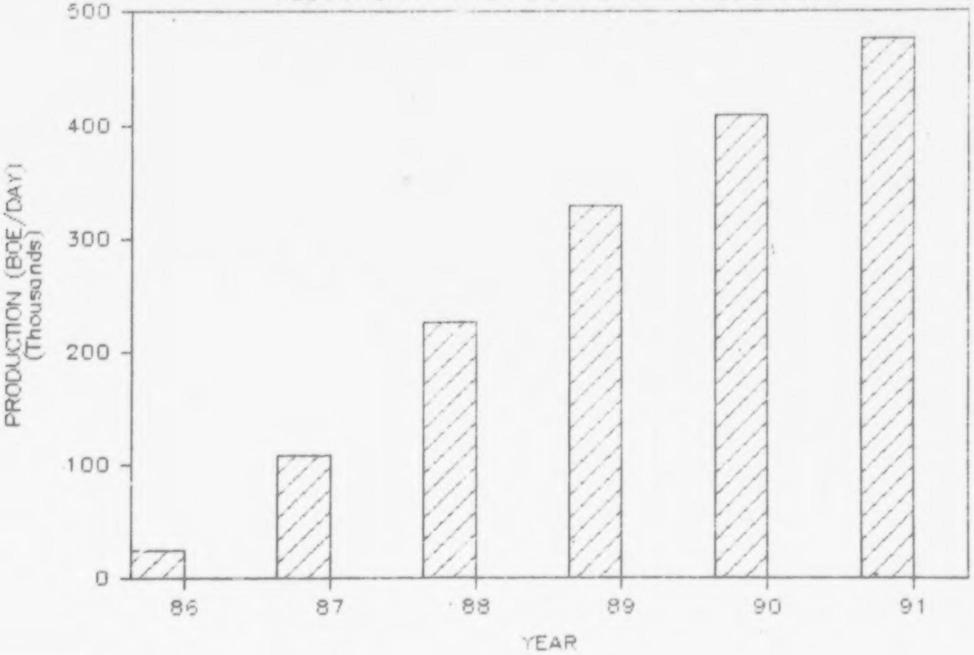
INTERSTATE OIL COMPACT COMMISSION

January 1985

TEXAS IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DAILY OIL AND GAS PRODUCTION.



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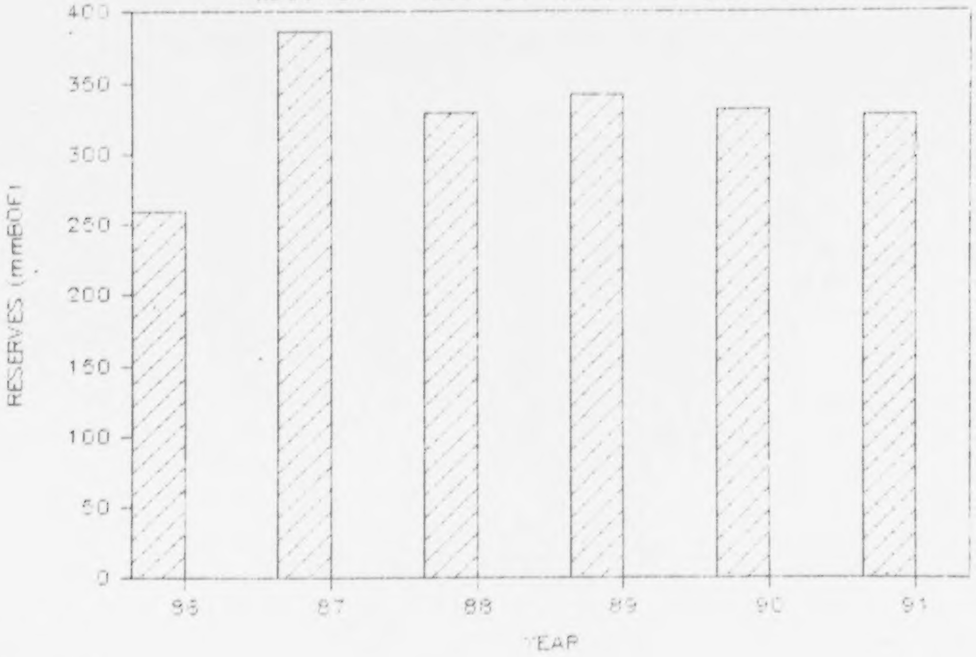
January 8, 1985

TEXAS IMPACT OF IDC TAX PROPOSAL

REDUCTION IN RESERVES ADDED AT $12.00 PER BOE



INTERSTATE OIL COMPACT COMMISSION

January 1985
OKLAHOMA

Preliminary Evaluation
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January 8 1985

OKLAHOMA
ANALYSIS OF THE IMPACT OF THE PROPOSED TAX TREATMENT
OF INTANGIBLE DRILLLING COSTS ON DRILLING EXPENDITURES,
WELLS DRILLED, EMPLOYMENT & RESERVES FOUND - 1986- 1991

1984 DRILLING RIGS	317
1983 WELL COST	$447,794
GPT TAX RATE	7.09%

	CURRENT LAW		TREASURY PROPOSAL								
YEAR	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	J.A.S. DRILLING EXPENDITURES ($mm)	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	J.A.S. DRILLING EXPENDITURES ($mm)	REDUCTION IN TOTAL CASH AVAILABLE FOR DRILLING ($mm)	REDUCTION IN DRILLING EXPENDITURES ($mm)	REDUCTION IN EMPLOYMENT (JOBS	REDUCTION IN TOTAL WELLS DRILLED	REDUCTION IN DRILLING RIG ACTIVITY	REDUCTION IN RESERVES ADDED (mmBOE)	REDUCTION IN DAILY PRODUCTION (BOE/DAY)
80	$2,918	$2,916	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
81	$5,244	$5,244	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
82	$7,559	$7,559	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
83	$3,697	$3,697	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
84	$3,697	$3,697	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
86	$3,697	$3,697	$2,233	$2,233	$1,464	$1,464	73,200	3,269	126	122	11,699
87	$3,697	$3,697	$1,518	$1,518	$2,179	$2,179	108,950	4,866	187	182	50,837
88	$3,697	$3,697	$1,842	$1,842	$1,855	$1,855	92,750	4,143	159	155	106,352
89	$3,697	$3,697	$1,771	$1,771	$1,926	$1,926	96,300	4,301	165	160	155,024
90	$3,697	$3,697	$1,825	$1,825	$1,872	$1,872	93,600	4,180	161	156	192,518
91	$3,697	$3,697	$1,852	$1,852	$1,845	$1,845	92,250	4,120	158	154	224,272
TOTAL	$22,182	$22,182	$11,041	$11,041	$11,141	$11,141	n.a.	24,880	n.a.	928	n.a.
AVERAGE	$3,697	$3,697	$1,840	$1,840	$1,857	$1,857	92,841	4,147	159	155	123,450

AVERAGE IMPACT 1986-91:

REDUCTION IN DRILLING EXPENDITURES YEARLY	$1,857 MILLION
REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:	92,841 JOBS
REDUCTION IN NUMBER OF WELLS DRILLED YEARLY	4,147 WELLS
REDUCTION IN DRILLING RIG RUNNING YEARLY	159 RIGS
REDUCTION IN RESERVES ADDED AT $12.00 PER BOE:	928 mmBOE
REDUCTION IN DAILY OIL AND GAS PRODUCTION:	123,450 BOE/DAY
REDUCTION IN OIL AND GAS SALES:	$885 MILLION
REDUCTION IN STATE GPT COLLECTIONS:	$63 MILLION

ASSUMPTIONS:

INDUSTRY EXPENDITURES ARE REDUCED BY ONE-THIRD IN 1986 DUE TO UNCERTAINTY AND REDUCED THIRD PARTY FUNDING
THIRD PARTY FUNDING IS REDUCED BY ONE-HALF IN 1986 DUE TO UNCERTAINTY IN TAX TREATMENT
AFTER 1986 INDUSTRY EXPENDITURES REMAIN AT TWO-THIRDS OF 1984 LEVELS + OR - REDUCED CASH FLOW FROM ACCELERATED TAX PAYMENTS.
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1986 AVERAGE WELLHEAD PRICE WAS $1[illegible]/BOE.
A REDUCTION IN DRILLING EXPENDITURES OF ONE MILLION DOLLARS RESULTS IN A LOSS OF 50 JOBS.

INTERSTATE OIL COMPACT COMMISSION

January 1985

OKLAHOMA

Preliminary Evaluation
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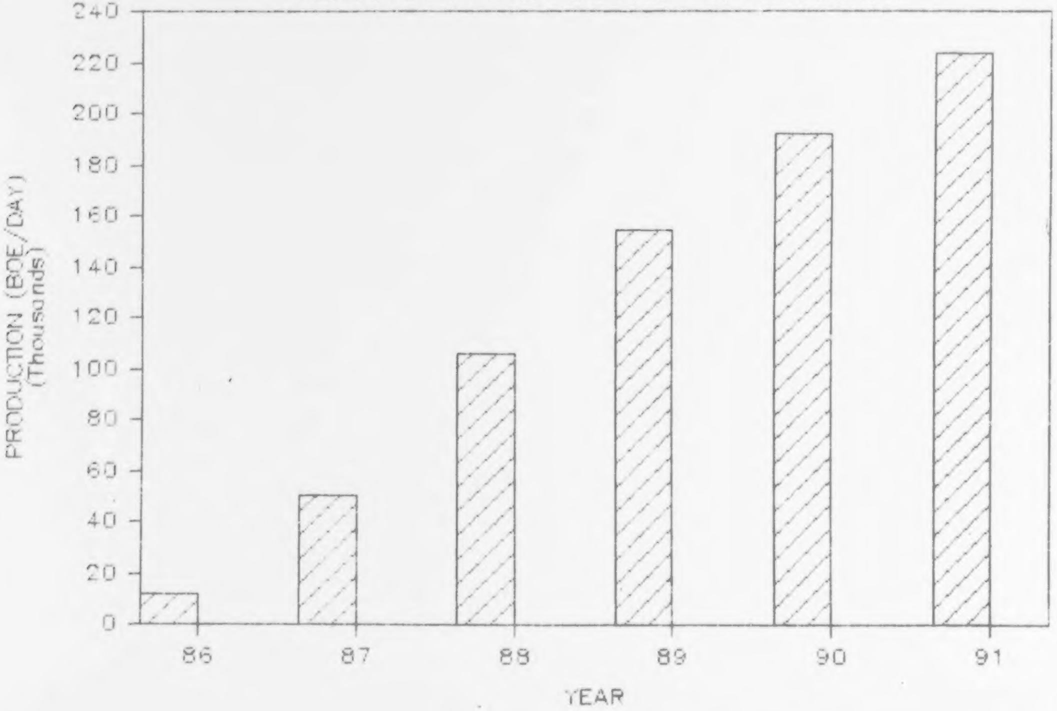
January 8 1985

IMPACT OF IDC TAX PROPOSAL

REDUCTION IN DAILY OIL AND GAS PRODUCTION



IMPACT OF IDC TAX PROPOSAL

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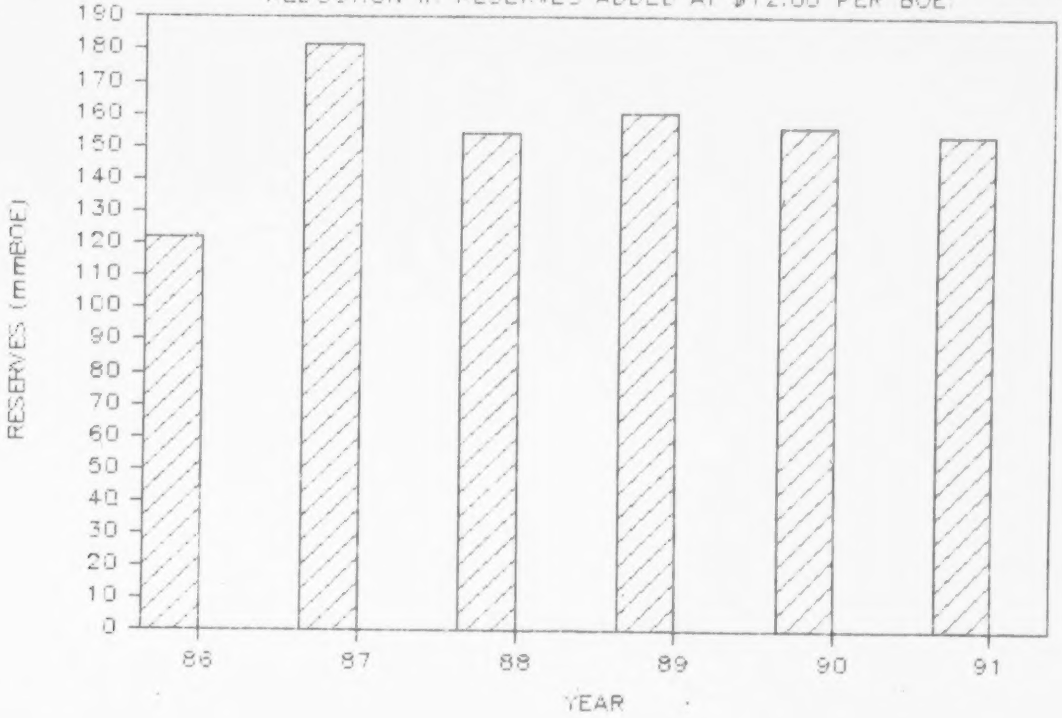

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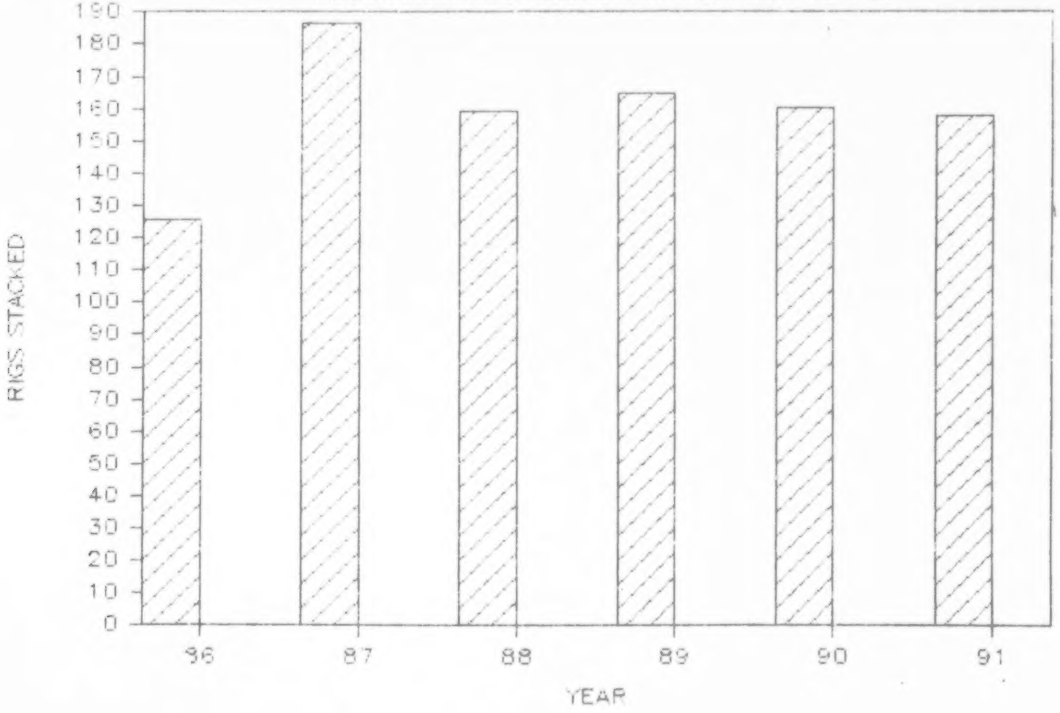

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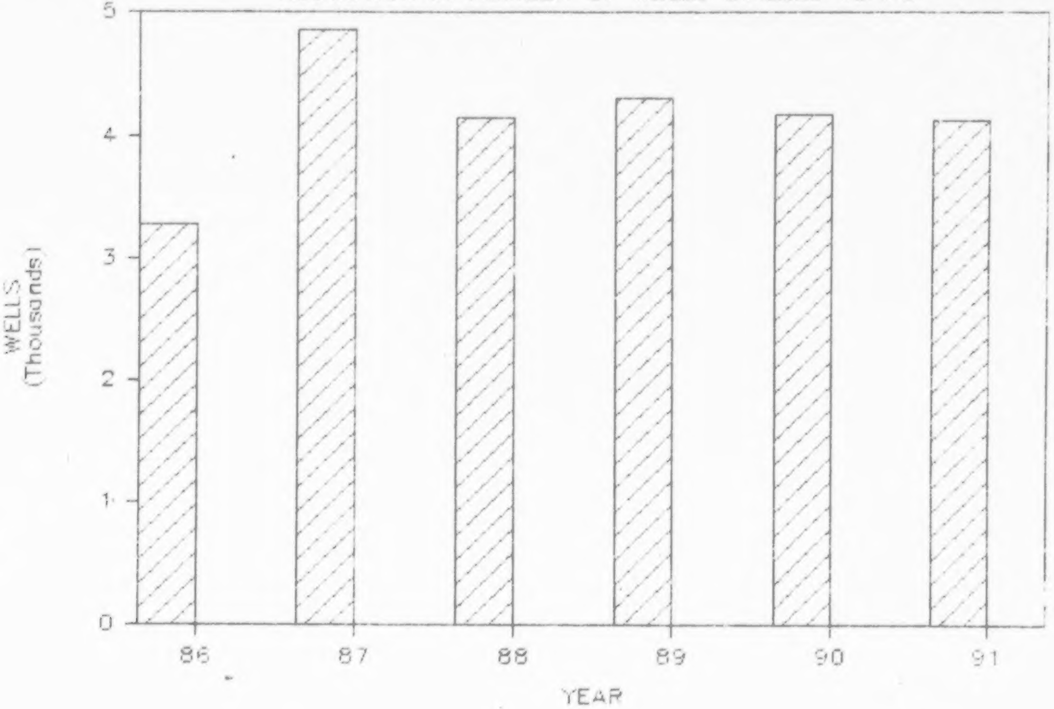

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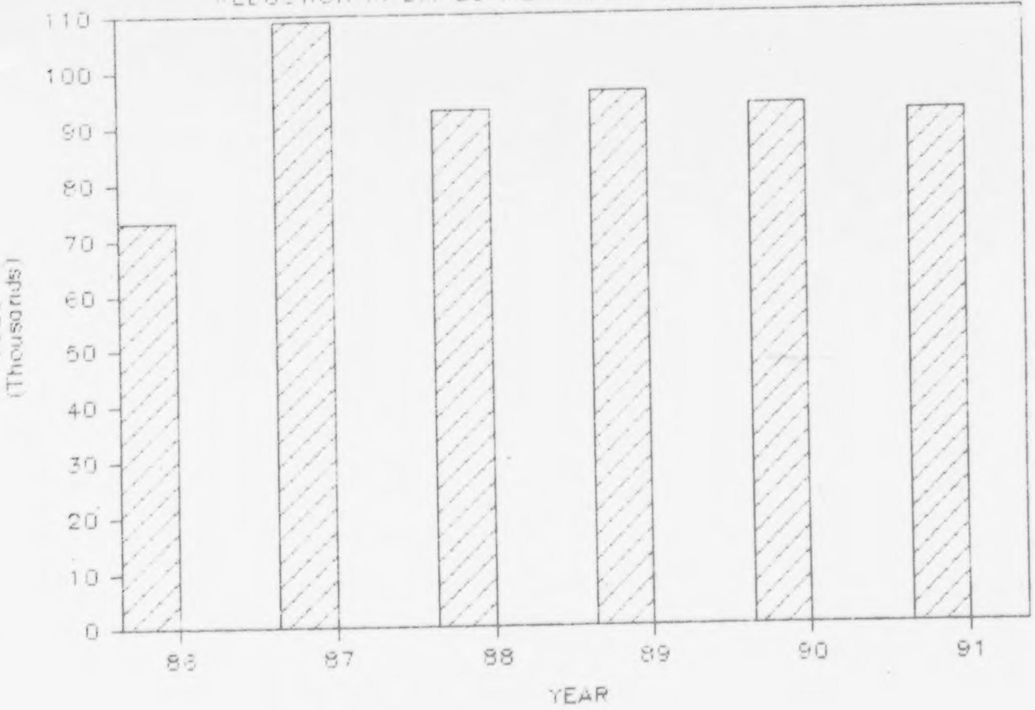
REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:



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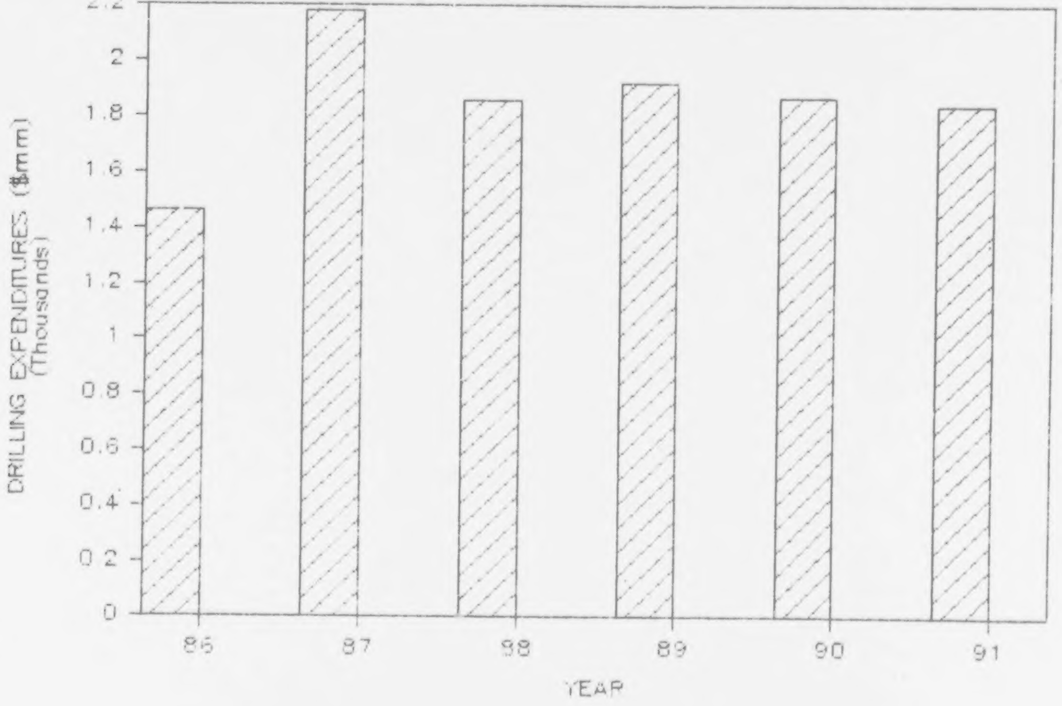
REDUCTION IN DRILLING EXPENDITURES YEARLY



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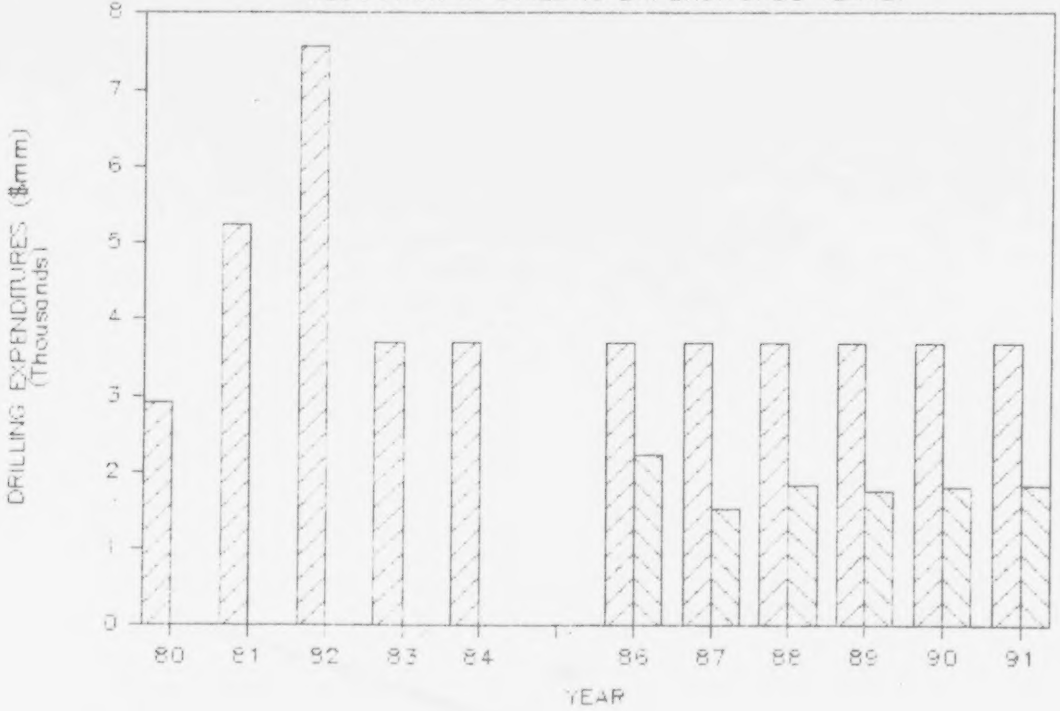

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WELLS DRILLED, EMPLOYMENT & RESERVES FOUND - 1986-1991

	CURRENT LAW			TREASURY PROPOSAL								
YEAR	INDUSTRY CASH AVAILABLE FOR DRILLING ($mm)	THIRD PARTY CASH AVAILABLE FOR DRILLING ($mm)	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	INDUSTRY CASH AVAILABLE FOR DRILLING ($mm)	THIRD PARTY CASH AVAILABLE FOR DRILLING ($mm)	TOTAL CASH AVAILABLE FOR DRILLING ($mm)	ACTUAL J.A.S. DRILLING EXPENDITURES ($mm)	EMPLOYMENT (JOBS)	TOTAL WELLS DRILLED	DRILLING RIG ACTIVITY 1984=317	RESERVES (mmBOE)	DAILY PRODUCTION (BOE/DAY)
80	$1,564	$1,354	$2,918	N.A.	N.A.	N.A.	$2,918	186,955	9,025	347	3,933	1,306,253
81	$2,058	$3,186	$5,244	N.A.	N.A.	N.A.	$5,244	225,646	11,699	698	4,255	1,380,695
82	$2,360	$5,199	$7,559	N.A.	N.A.	N.A.	$7,559	238,740	12,030	622	4,675	1,353,178
83	$2,167	$1,530	$3,697	N.A.	N.A.	N.A.	$3,697	174,427	9,950	293	4,605	1,234,377
84	$2,294	$1,403	$3,697	N.A.	N.A.	N.A.	$3,697	164,850	10,053	317	4,535	1,422,771
86	$2,294	$1,403	$3,697	$1,529	$702	$2,231	$2,231	91,542	6,784	191	4,221	1,369,526
87	$2,294	$1,403	$3,697	$1,040	$477	$1,517	$1,517	55,827	5,187	130	3,883	1,274,718
88	$2,294	$1,403	$3,697	$1,261	$579	$1,840	$1,840	72,003	5,910	158	3,608	1,172,385
89	$2,294	$1,403	$3,697	$1,213	$556	$1,769	$1,769	68,462	5,752	152	3,358	1,089,471
90	$2,294	$1,403	$3,697	$1,250	$573	$1,823	$1,823	71,146	5,873	156	3,140	1,013,914
91	$2,294	$1,403	$3,697	$1,268	$582	$1,850	$1,850	72,510	5,933	159	2,948	948,035
TOTAL 1986-91	$13,764	$8,418	$22,182	$7,561	$3,468	$11,030	$11,030	71,915	35,439	158	21,157	1,144,675
AVERAGE	$2,294	$1,403	$3,697	$1,260	$578	$1,838	$1,838	71,915	5,907	158	3,526	1,144,675

AVERAGE IMPACT 1986-91:

REDUCTION IN DRILLING EXPENDITURES YEARLY	$1,859	MILLION
REDUCTION IN EMPLOYMENT DUE TO REDUCED DRILLING:	92,935	AVERAGE JOBS LOST 1986-1991
REDUCTION IN WELLS DRILLED BASED ON $447,800 PER WELL	24,880	WELLS NOT DRILLED 1986-1991
REDUCTION IN DRILLING RIG ACTIVITY:	159	DRILLING RIGS STACKED
REDUCTION IN RESERVES ADDED AT $12.00 PER BOE:	928	MILLION BARRELS OF OIL EQUIVALENT
REDUCTION IN DAILY OIL AND GAS PRODUCTION:	125,450	EQUIVALENT BARRELS OF OIL AND GAS NOT PRODUCED
REDUCTION IN OIL AND GAS SALES:	$685	MILLION AVERAGE ANNUAL REDUCTION IN OIL AND GAS REVENUES 1986-1991
REDUCTION IN STATE GPT COLLECTIONS:	$63	MILLION AVERAGE LOST GROSS PRODUCTION TAX RECEIPTS ANNUALLY 1986- 1991

ASSUMPTIONS:

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1984 OKLAHOMA PRODUCTION WAS [illegible] MILLION BARRELS OF OIL EQUIVALENT.
1984 OKLAHOMA AVERAGE WELLHEAD PRICE WAS $[illegible] BOE.
A REDUCTION IN DRILLING EXPENDITURES OF ONE MILLION DOLLARS RESULT IN A LOSS OF 50 JOBS.

50 Years of Conservation of Oil & Gas
1935 1985

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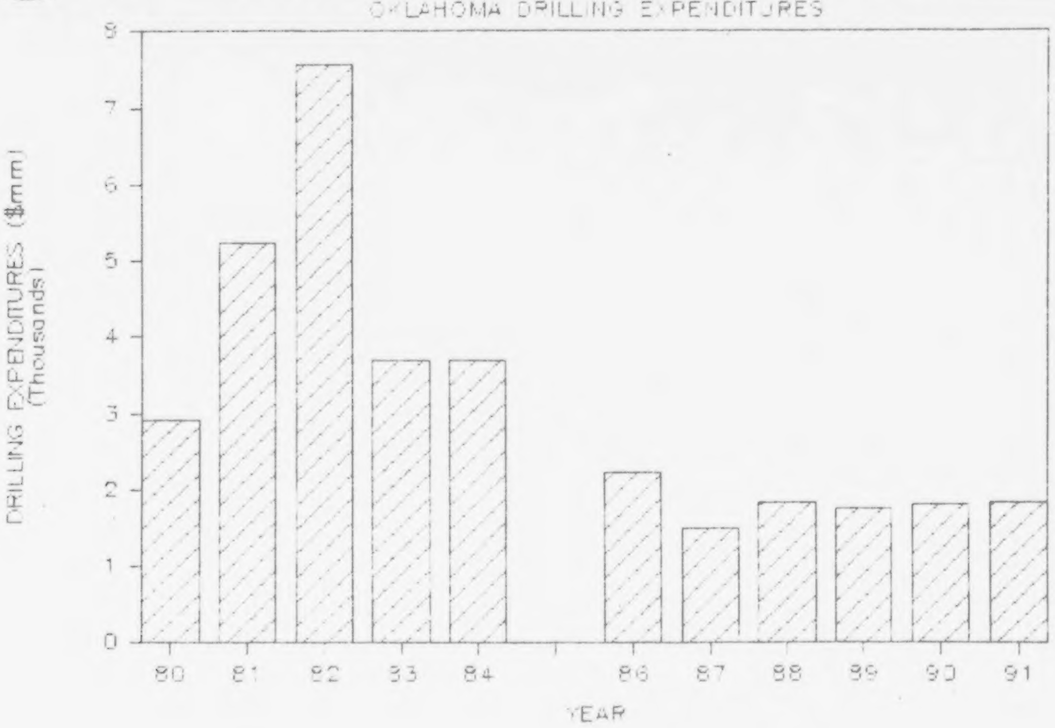
IMPACT OF IDC TAX PROPOSAL



50 Years of Conservation of Oil & Gas 1935-1985

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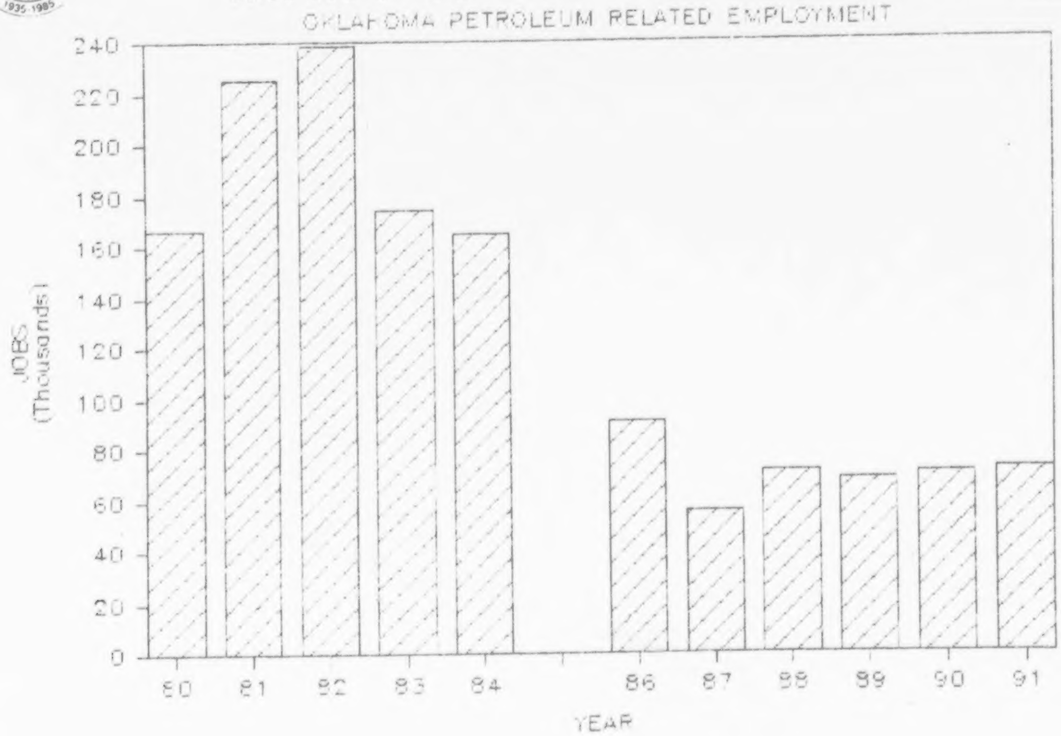

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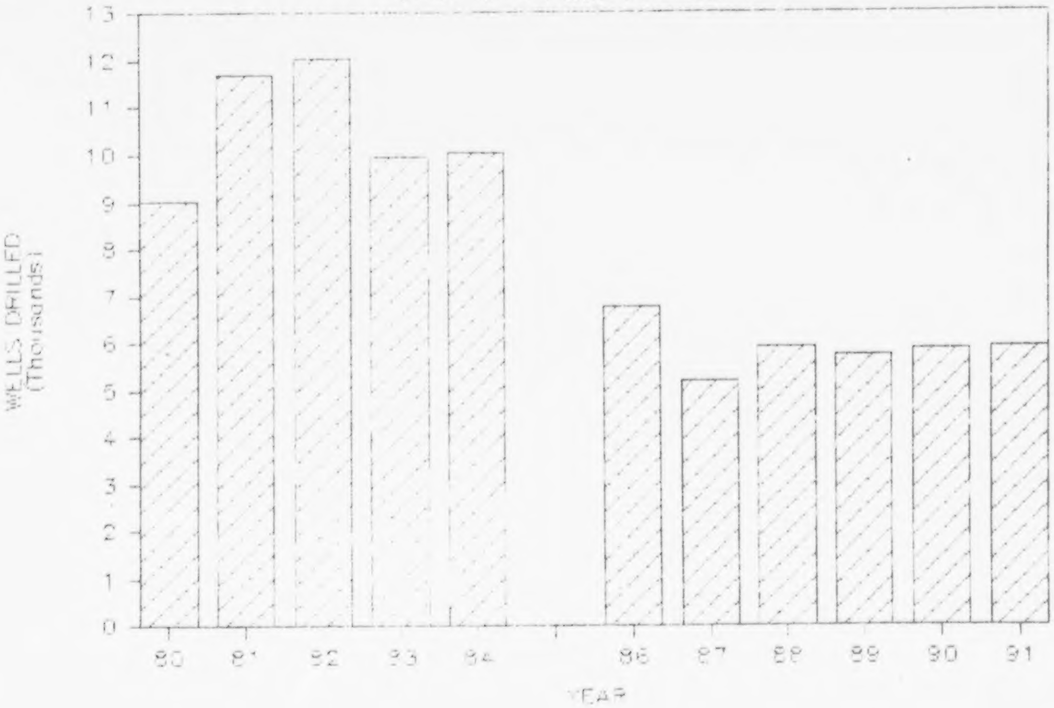
IMPACT OF IDC TAX PROPOSAL

OKLAHOMA WELL COMPLETIONS



RIG

COMPARISION OF OKLAHOMA & NATIONAL DRILLING RIG ACTIVITY
AFTER TREASURY SECRETARY REGAN'S NOVEMBER 27, 1984 TAX PROPOSALS
AFFECTING DEPLETION & INTANGIBLE DRILLING COST
TAX TREATMENT BASED ON 1983 & 1984 YEAR END ACTIVITY

DATE	NATIONAL ACTUAL 1983	NATIONAL ACTUAL 1984	NATIONAL ESTIMATED* 1984	NATIONAL DIFFERENCE 1984	TEXAS ACTUAL 1983	TEXAS ACTUAL 1984	TEXAS ESTIMATED* 1984	TEXAS DIFFERENCE 1984	OKLAHOMA ACTUAL 1983	OKLAHOMA ACTUAL 1984	OKLAHOMA ESTIMATED* 1984	OKLAHOMA DIFFERENCE 1984
248	2210	2424	2424	0	805	811	811	0	261	278	278	0
255	2247	2377	2377	0	827	805	805	0	253	281	281	0
262	2280	2438	2438	0	849	828	828	0	253	294	294	0
269	2269	2441	2441	0	857	833	833	0	248	286	286	0
276	2312	2452	2452	0	857	862	862	0	253	280	280	0
283	2387	2487	2487	0	871	852	852	0	264	284	284	0
290	2383	2506	2506	0	876	844	844	0	263	305	305	0
297	2418	2511	2511	0	886	860	860	0	250	311	311	0
304	2409	2503	2503	0	879	863	863	0	247	307	307	0
311	2473	2554	2554	0	878	856	856	0	255	308	308	0
318	2556	2597	2597	0	917	878	878	0	289	318	318	0
325	2593	2683	2683	0	932	891	891	0	305	332	332	0
332	2661	2682	2682	0	934	944	944	0	332	326	326	0
339	2704	2686	2830	144	950	920	930	10	342	328	385	57
346	2746	2728	2874	146	967	938	946	8	355	326	400	74
353	2800	2787	2930	143	979	953	958	5	376	352	423	71
360	2870	2650	3003	353	977	917	956	39	418	309	471	162

NOTE: * BASED ON 1983 RIG COUNT TRENDLINES AFTER NOVEMBER 27, 1984.

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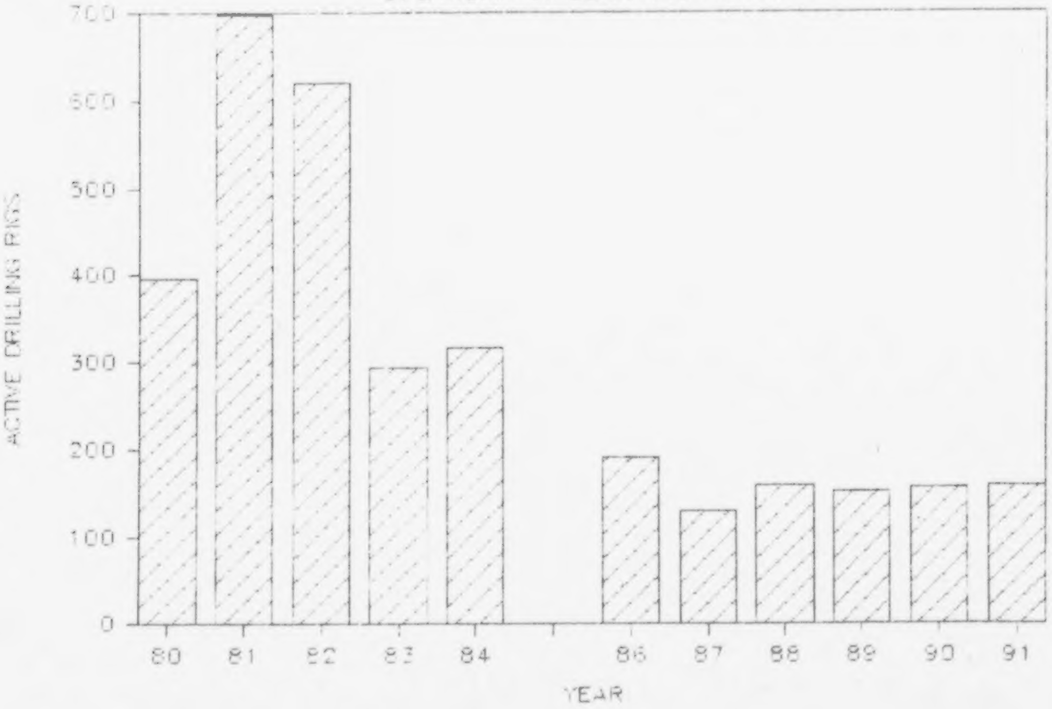
IMPACT OF IDC TAX-PROPOSAL

OKLAHOMA DRILLING RIG ACTIVITY



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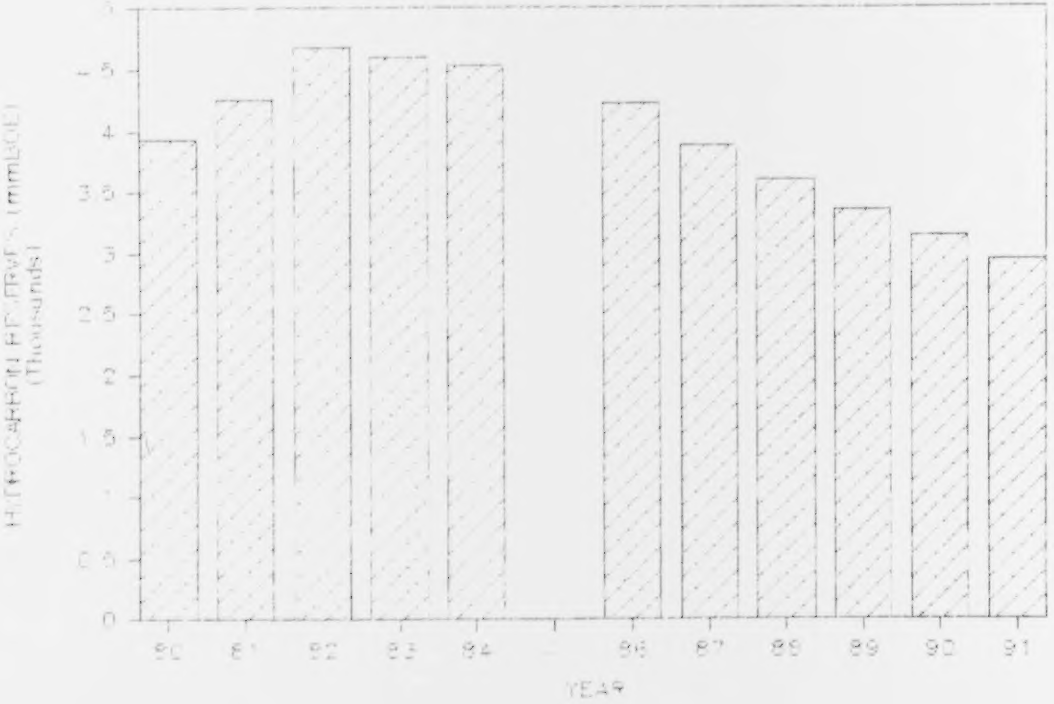
IMPACT OF IDC TAX PROPOSAL

OKLAHOMA HYDROCARBON RESERVES



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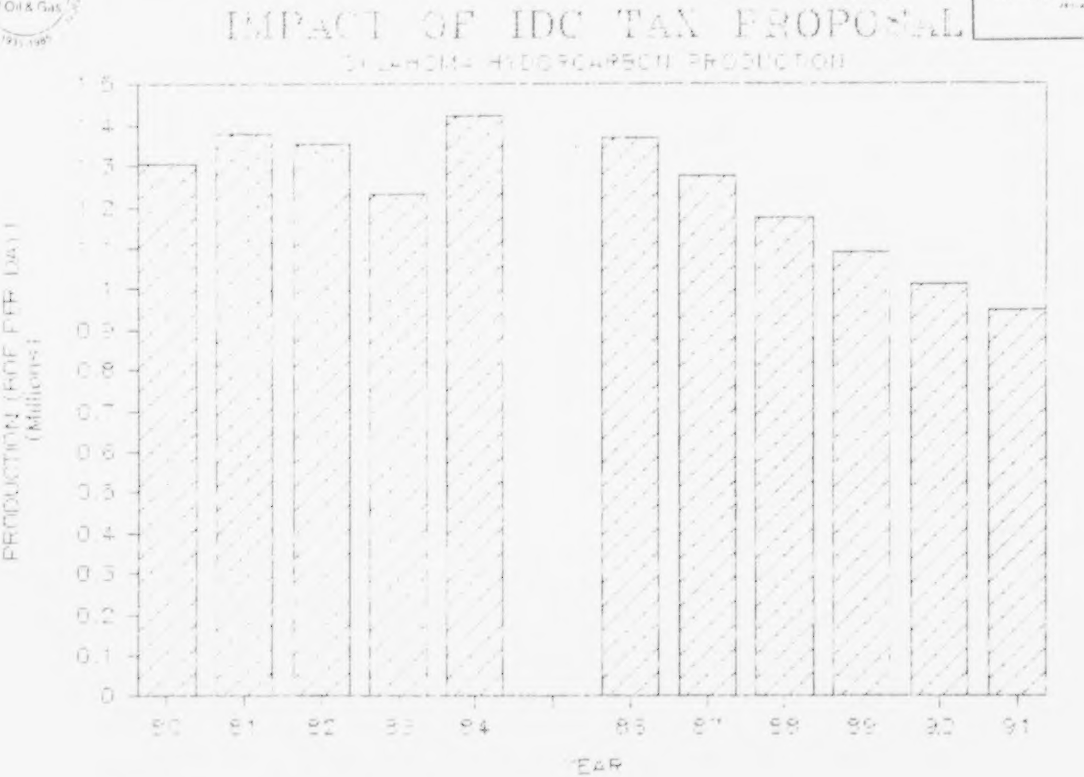
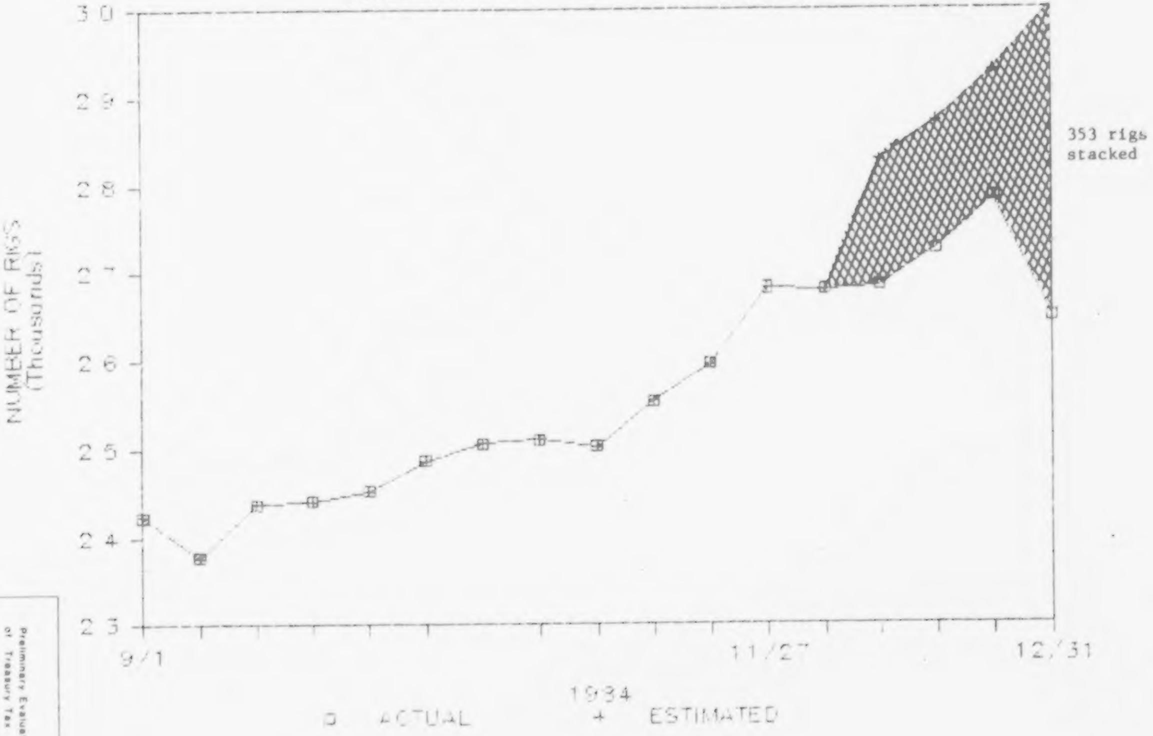


NATIONAL RIG COUNT

COMPARISION OF ACTUAL TO ESTIMATED



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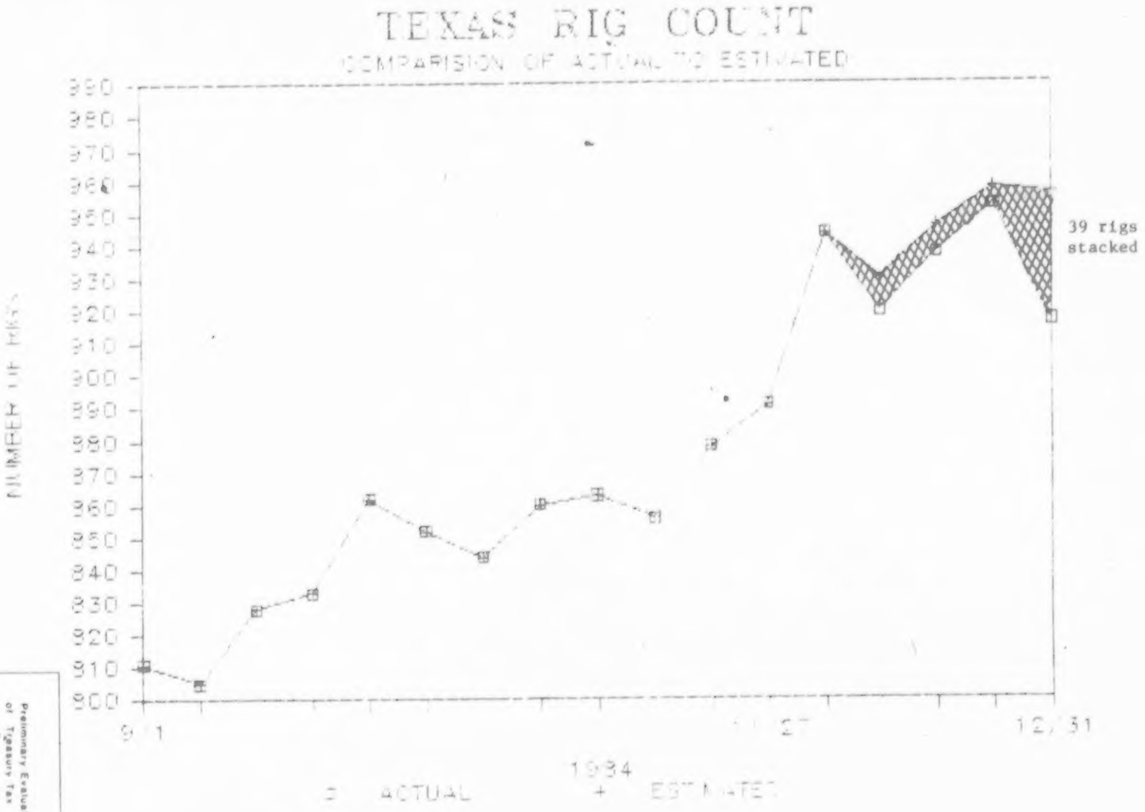

39 rigs stacked

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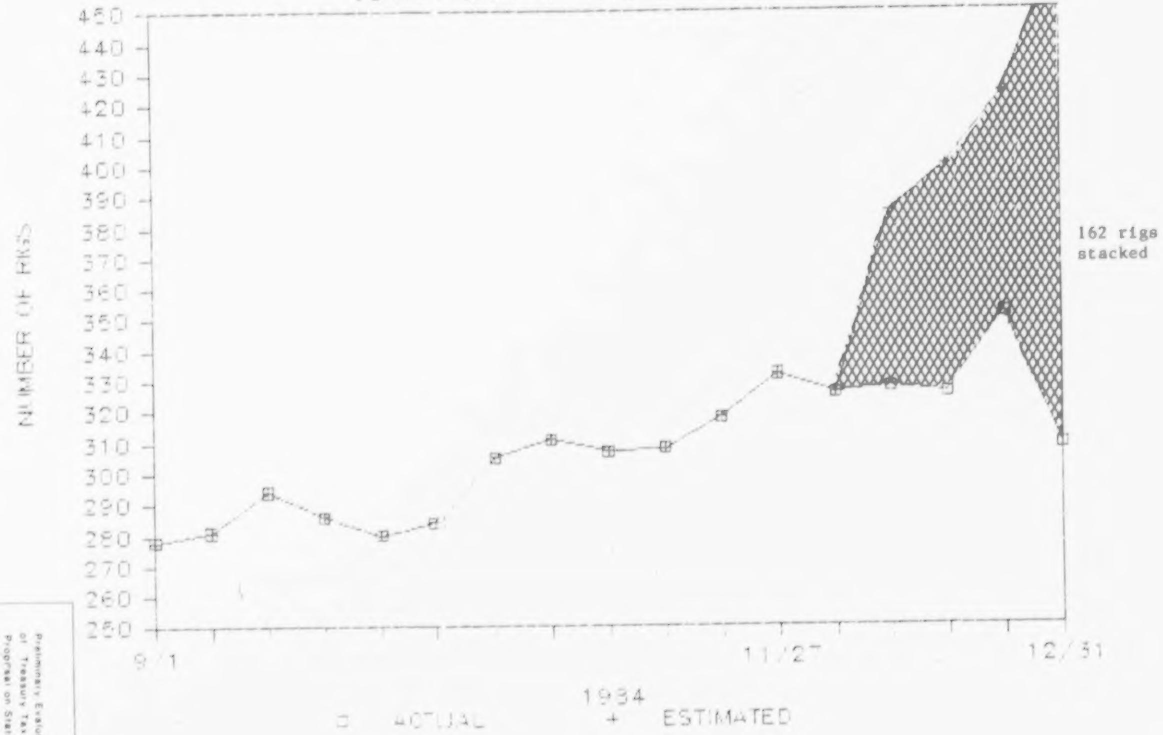

OKLAHOMA RIG COUNT

COMPARISION OF ACTUAL TO ESTIMATED

162 rigs stacked

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IMPACT OF FEDERAL TAX PROPOSALS ON ENHANCED OIL RECOVERY

Introduction

The purpose of this study is to forecast the impact of the Treasury Department's recent tax proposals on ongoing and projected enhanced oil recovery ("EOR") operations.

Enhanced oil recovery is the incremental oil that can be economically produced from a petroleum reservoir over that which can be economically recovered by conventional primary and secondary production methods. Primary methods rely on the natural reservoir energy to drive the oil through reservoir rock to producing wells. Over time, this natural energy drive dissipates, and energy must be added to the reservoir to produce significant amounts of additional oil.

Conventional secondary recovery methods introduce additional energy through the injection of water or gas, under pressure, into the formation at substantial additional costs. Enhanced oil recovery techniques are employed to achieve further production after primary and secondary recovery has been exhausted. Examples of enhanced oil recovery methods include: chemical flooding, miscible flooding, injection of carbon dioxide and thermal recovery.

Existing EOR projects currently account for 6% of U.S. daily oil production. The resource to which enhanced oil recovery may be applied in the future is very large, because conventional primary and secondary methods are expected to recover only about one-third of the oil originally discovered. Although much of the remaining two-thirds of the oil originally-in-place is not producible, a significant portion of this remaining resource constitutes the target for EOR.

Oil production by enhanced recovery is more costly than production by most conventional methods. Because of these high costs and heavy front-end investments required for most EOR projects, tax policies which reduce the after-tax cash flow available to producers will result in significant reductions in the number of projects undertaken and thus, the amount of oil recovered. Moreover, tax policies which hasten the abandonment of marginally economic fields remove the reserves remaining in the fields as potential resources for enhanced recovery.

The Treasury Department's recent tax proposals would effect several tax provisions that currently encourage EOR projects. These proposals would change depreciation schedules and repeal the following tax provisions: percentage depletion; the expensing on intangible drilling costs; the deduction of qualified tertiary injectant expenses; and, the investment tax credit. Although the Treasury Department proposal would also lower the marginal tax rate and repeal the Windfall Profit Tax, these favorable changes would be more than offset by the increased taxes resulting from the other changes described above.

Major Findings

The study found that the Treasury Department's tax proposals would have a significant negative impact on EOR projects. The reduced after-tax cash flow available to producers under the Treasury tax proposal would effect enhanced oil recovery in the United States in the years ahead as follows:

-- 7,908 fewer EOR projects would be undertaken;

-- oil production from EOR projects would be reduced by 1,832 million barrels;

-- royalty payments would drop by $10,351,000,000;

-- property and severance tax payments would fall by $2,228,000,000;

-- state income tax collections would be reduced by $635,000,000;

-- federal income tax collections from third parties would fall by $1,313,000,000;

-- reductions in payments to suppliers of good and services would equal $34,174,000,000;

-- equipment purchases would fall by $2,250,000,000;

-- intangible drilling costs for EOR wells would decrease by $896,000,000

Basis for Projections

These projections are based on an EOR data base and economic model developed by the Bartlesville Energy Center, and on "Enhanced Oil Recovery," a report by the National Petroleum Council to the Secretary of Energy, dated June 21, 1984.

INTERSTATE OIL COMPACT
COMMISSION

Impact of Federal Tax Proposals on Stripper Oil Wells

50
Years of
Conservation
of Oil & Gas
1935-1985

IMPACT OF REMOVAL OF PERCENTAGE DEPLETION ON STRIPPER OIL WELLS AND ON THE NATIONAL ECONOMY

Introduction

The purpose of this study is to determine the impact on the United States' economy of removing from the federal tax laws the provision for percentage depletion on stripper oil wells.

A stripper oil well is one that produces less than 10 barrels per day. The importance of stripper wells to domestic oil production is shown on Table One, National Historical Stripper Well Statistics 1980-83 With Projected Impact Of Removal Of Percentage Depletion in 1986. At year-end 1983, the nation had more than 441,501 stripper wells producing an average of 2.87 barrels per day. Total annual stripper well production in 1983 was 462,010,000 barrels of oil, or 21.74% of total national production. Total stripper well reserves at year end 1983 were 4,590,810,000 barrels.

Under current federal tax laws, independent oil and gas producers and royalty owners are allowed to deduct 15% of the gross revenues from a limited amount of their oil and gas production, provided that the amount of percentage depletion allowed cannot exceed 50% of the net income from a particular property. The amount of oil and gas subject to percentage depletion allowed cannot exceed an average daily production of 1,000 barrels of oil or 6,000 Mcf of gas.

Percentage depletion, when allowed and if greater than cost depletion, must be taken in lieu of cost depletion. Percentage depletion allowed is deducted from capitalized costs, but may continue to be taken even if all capitalized costs have been recovered. Cost depletion may be taken only to the extent of capitalized costs.

This study focuses on stripper wells operated by independent producers, who operate two out of every three stripper wells. Production from these wells is not subject to the windfall profit tax, and most stripper wells have very low or no cost basis, so there is little or no tax basis for cost depletion. Therefore, disallowing the percentage depletion deduction on stripper oil wells, for which cost depletion is unavailable, would result in a direct and measurable loss of after-tax revenues for independent producers and royalty owners, and a significant adverse impact on the national economy.

The loss of revenues for independent producers and royalty owners resulting from the removal of percentage depletion on all their oil and gas production would be even greater.

However, measuring this loss and its impact on the national economy is outside the scope of this study.

Major Findings

The study found that removing percentage depletion on stripper wells would have the following results in the first year alone:

- 36,597 stripper wells would be abandoned because they would no longer be economic to operate;
- domestic oil production would be reduced by 78,910 barrels per day due to premature abandonment, and by 2,400 barrels per day due to decreased drilling;
- oil and gas revenues would be reduced by $771,630,000;
- royalty payments would fall by $115,700,000;
- severance tax payments would drop by $61,700,000;
- oil and gas drilling would be cut back by $308,600,000;
- 70,200 jobs would be lost in the petroleum and other industries;

In addition, 849,000,000 barrels of proven developed oil reserves would be lost as the stripper wells are plugged and abandoned. This compares to 450,900,000 barrels stored in the National Strategic Petroleum Reserve at a cost to the taxpayers through fiscal 1984 of $14,500,000,000.

Background on Percentage Depletion

Percentage depletion is a tax provision that dates back to before 1920 and applies not just to oil and gas, but to other natural resources such as coal. The tax laws often distinguish between capital and income so capital is returned for future investments. But as an oil well produces, the producer's capital is being steadily depleted. So the percentage depletion deduction was established to prevent a gradual loss of capital by leaving the producer with more after-tax dollars needed to drill new wells and, thereby, replace the depleted reserves.

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50 Years of Conservation of Oil & Gas
1935-1985

IMPACT OF FEDERAL TAX PROPOSALS ON ENHANCED OIL RECOVERY (EOR)

REDUCTIONS	U.S.*	ALASKA*	ARKANSAS*	CALIFORNIA*	COLORADO*	FLORIDA*	KANSAS*
	(Millions of Dollars)						
IN ROYALTY PAYMENTS	10,351	184	77	1,221	200	42	65
IN PROPERTY & SEVERANCE TAX PAYMENTS	2,228	8	32	245	76	17	42
IN STATE INCOME TAX COLLECTIONS	635	66	17	77	9	6	(1)
IN FEDERAL INCOME TAX COLLECTIONS	1,313	(220)	74	(1,473)	4	(25)	(72)
IN PAYMENTS TO THIRD PARTIES	34,174	1,404	428	7,978	947	194	332
IN EQUIPMENT PURCHASES	2,250	14	6	(887)	26	3	9
IN IDC'S FOR EOR WELLS	896	8	5	44	75	32	212
TOTAL	51,847	1,464	639	7,205	1,337	269	587
IN EOR PRODUCTION#	1,832	94	21	423	54	6	17

* All impacts are cumulative.

# Millions of barrels.

Basis:

- National Petroleum Council Enhanced Oil Recovery, June, 1984 and Bartlesville Project Office (DOE) EOR Data Base and Economic Model.
- Actual state by state current property and severance tax rates.
- Actual state by state income tax rates.
- Provisions of Secretary Regan's November, 1984 tax proposal regarding:
  - Intangible investments
  - Tertiary injectants
  - Revised ACRS depreciation
  - No tax credit
  - Modified depreciation schedules
  - Crude oil price of $30.00 per barrel
  - 10% rate of return on investment

January 1985

Preliminary Evaluation
of Treasury Tax
Proposal on State Resources,
Economy, and Tax Revenues
January 8, 1985

IMPACT OF FEDERAL TAX PROPOSALS ON ENHANCED OIL RECOVERY EOR

REDUCTIONS	U.S.*	KENTUCKY*	LOUISIANA*	MISSISSIPPI*	MONTANA*	NEBRASKA*	NEW MEXICO*
	(Millions of Dollars)						
IN ROYALTY PAYMENTS	10,351	0	(48)	60	86	29	806
IN PROPERTY & SEVERANCE TAX PAYMENTS	2,228	0	75	29	43	8	530
IN STATE INCOME TAX COLLECTIONS	635	4	(58)	6	11	3	92
IN FEDERAL INCOME TAX COLLECTIONS	1,313	13	(136)	28	54	12	353
IN PAYMENTS TO THIRD PARTIES	34,174	75	311	250	406	161	3,471
IN EQUIPMENT PURCHASES	2,250	0	(3)	8	10	5	95
IN IDC'S FOR EOR WELLS	896	0	(45)	29	19	2	271
TOTAL	51,847	92	96	410	629	220	5,618
IN EOR PRODUCTION#	1,832	0	(14)	16	23	8	288

* All impacts are cumulative.

# Millions of barrels.

Basis:

- National Petroleum Council Enhanced Oil Recovery, June, 1984 and Bartlesville Project Office (DOE) EOR Data Base and Economic Model.
- Actual state by state current property and severance tax rates.
- Actual state by state income tax rates.
- Provisions of Secretary Regan's November, 1984 tax proposal regarding:
  - Intangible investments
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  - Revised ACRS depreciation
  - No tax credit
  - Modified depreciation schedules
  - Crude oil price of $30.00 per barrel
  - 10% rate of return on investment

IMPACT OF FEDERAL TAX PROPOSALS ON ENHANCED OIL RECOVERY EOR

REDUCTIONS	U.S.*	NORTH DAKOTA*	OKLAHOMA*	TEXAS*	UTAH*	WYOMING*	OTHER*
	(Millions of Dollars)						
IN ROYALTY PAYMENTS	10,351	193	768	1,558	(4)	41	5,073
IN PROPERTY & SEVERANCE TAX PAYMENTS	2,228	177	435	567	0	21	(77)
IN STATE INCOME TAX COLLECTIONS	635	34	70	0	(9)	0	308
IN FEDERAL INCOME TAX COLLECTIONS	1,313	82	469	(693)	(109)	(38)	2,990
IN PAYMENTS TO THIRD PARTIES	34,174	913	3,629	9,656	(26)	227	3,818
IN EQUIPMENT PURCHASES	2,250	23	60	432	0	6	2,443
IN IDC'S FOR EOR WELLS	896	41	69	408	0	(19)	(255)
TOTAL	51,847	1,463	5,500	11,928	(148)	238	14,300
IN EOR PRODUCTION#	1,832	51	209	465	(1)	12	

* All impacts are cumulative.

Millions of barrels.

Basis:

- National Petroleum Council Enhanced Oil Recovery, June, 1984 and Bartlesville Project Office (DOE) EOR Data Base and Economic Model.
- Actual state by state current property and severance tax rates.
- Actual state by state income tax rates.
- Provisions of Secretary Regan's November, 1984 tax proposal regarding:
  - Intangible investments
  - Tertiary injectants
  - Revised ACRS depreciation
  - No tax credit
  - Modified depreciation schedules
  - Crude oil price of $30.00 per barrel
  - 10% rate of return on investment

From 1926 to 1969, oil operators were generally allowed to deduct 27.5% of gross income from an oil property as percentage depletion. The 1969 Tax Reform Act cut the depletion percentage for oil properties to 22%. In 1975, a new tax law eliminated percentage depletion on oil properties for all major oil companies. But the law allowed small, non-integrated independent producers to keep their percentage depletion deduction at 22% until 1980, then gradually declining to 15% in 1984.

Stripper Well Economics

Tables Two, Three and Four show the estimated pre-tax and after-tax proceeds to major and independent producers with and without percentage depletion for the years 1974 through 1984. Average royalties are estimated at 15%, and severance taxes at 6%. Operating costs were estimated based on a survey of petroleum engineering firms and are the major variable in these three tables. Table Two is based on low operating costs; Table Three on medium operating costs, and Table Four on high operating costs. For the economic impact projections, the stripper well economics summarized in Table Three were used.

Chart One, Net Pre-Tax Proceeds to Independent Stripper Well Producers, shows that the pre-tax proceeds have dropped from $14.19 per barrel in 1981 to $7.93 per barrel in 1984. Chart Two, Value of Depletion to Independent Stripper Well Producers, shows that the value of percentage depletion to the independent producer has dropped from $2.58 per barrel in 1981 to $1.83 per barrel in 1984. This downward trend is expected to continue in 1986.

Note in Table Three that an independent producer in 1984 would receive net after-tax income of $5.80 per barrel under the current law, but only $3.96 per barrel without percentage depletion. Thus, the net effect of eliminating percentage depletion in 1984 would be $1.83 per barrel.

The economic life of these stripper wells is shortened by reductions in after-tax income regardless of whether the decrease results from falling prices, rising costs, or higher tax rates.

As seen in Chart Three, Net After-Tax Proceeds To Independent Stripper Well Producers, net after-tax proceeds have already dropped from $9.67 per barrel in 1981 to $5.80 per barrel in 1984. An additional tax burden resulting from removing percentage depletion would shorten the economic like of the average stripper well by 3.75 years, assuming there is no further decline in oil prices. This calculation is based on the average stripper well life of 25.8 years, the average stripper well production decline rate of 5.5% per year, and the change in net after-tax revenue to the operator from removal of percentage depletion. (See Table Five, National Stripper Well Summary, 1954-1983.)

Production and Reserve Losses

Chart Four, National Number of Stripper Wells, shows the total number of stripper wells operating annually in the United States from 1980 through 1986. An estimated 36,597 stripper wells would be abandoned in 1986 alone due to the removal of percentage depletion. As seen on Chart Five, National Abandonment of Stripper Wells, this would more than triple the annual abandonments in 1982-84. These abandonments would cause stripper well production to drop by 78,910 barrels per day, which would have to be replaced by imported oil. (See Chart Six, National Stripper Well Production, and Table Six, Summary Of The Impact Of The Removal Of Percentage Depletion For Stripper Well Properties.)

The proven developed oil reserves attributable to these wells would no longer be available. As shown on Chart Seven, National Stripper Well Reserves, and Table Six, these lost reserves total 849,000,000 barrels, or a 17.8% drop in total stripper well reserves.

Most oil wells eventually become stripper wells toward the end of their producing life. As stripper wells approach their economic limits and become candidates for plugging, only about 25% of the original oil in place has been produced by the primary reservoir drive. The use of secondary and other enhanced recovery measures can increase the resource recovered by an additional 15%. However, if a producer wants to make an additional investment in an enhanced recovery project, the first thing he needs is existing wells. If the stripper wells have been prematurely plugged, they are obviously unavailable for enhanced recovery projects. Therefore, prolonging the life of producing oil wells is even more important when one considers that the United States holds 300 billion barrels of discovered but unproduced oil that can only be tapped through enhanced recovery methods.

Adverse Economic Impact

As stated earlier, the reduction in oil production would cause the revenues to independent oil producers to drop by $771,630,000, reduce royalty payments by $115,700,000 and reduce severance tax payments by $61,700,000. Based on historical industry averages, every dollar in lost oil and gas revenue by independent producers results in $0.40 less spent to drill new wells. Thus, 1985 drilling expenditures would drop by nearly $308,600,000. (See Table Six.)

Economic research has found that, for every $1,000,000 of oil and gas revenue lost, employment drops by 91 jobs. Of these lost jobs, only 39 would be in the petroleum industry, while 52 would be in other industries affected indirectly by the reduced economic activity. Therefore, a total of 70,200 jobs would be lost in 1985 alone.

Conclusion

Eliminating percentage depletion on stripper well production would increase abandonments of stripper wells four-fold and significantly reduce drilling and production activity. The subsequent impact on the nation's economy would be severe. The nation's oil resource base available for secondary and other enhanced recovery projects would be reduced by millions of barrels. The major beneficiaries of such an ill-advised change in the tax laws would be foreign nations increasing their oil exports to the United States.

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SUMMARY

Impact of Federal Tax Proposals on Stripper Oil Wells

LOSS OF CRUDE OIL

EFFECT OF LOSS OF PERCENTAGE DEPLETION	NATIONALLY	TEXAS	OKLAHOMA	
STRIPPER WELLS ABANDONED	36,597	9,713	6,445	Wells
OIL RESERVES LOST*	849,000,000	225,000,000	150,000,000	Barrels
REDUCED OIL PRODUCTION DUE TO:				
PREMATURE ABANDONMENT	78,910	20,940	15,500	Bbls.per day
DECREASED 1985 DRILLING	2,400	575	400	Bbls.per day
ECONOMIC IMPACT IN FIRST YEAR TOTAL	81,310	21,515	15,900	Bbls.per day
REDUCTION IN OIL AND GAS REVENUES	$749,000,000	$198,000,000	$147,000,000	Per year
REDUCTION IN ROYALTY PAYMENTS	$113,000,000	$ 30,000,000	$ 22,000,000	Per year
REDUCTION IN SEVERANCE TAX PAYMENTS	$ 45,000,000	$ 9,100,000	$ 10,400,000	Per year
REDUCTION IN 1985 DRILLING	$300,000,000	$ 72,000,000	$ 54,000,000	Per year
REDUCTION IN JOBS	69,000	18,000	14,000	

*Reserves figure is cumulative. All others are first year only.

-- more --

MEMBER STATES: ALABAMA · ALASKA · ARIZONA · ARKANSAS · CALIFORNIA · COLORADO · FLORIDA · ILLINOIS · INDIANA · KANSAS · KENTUCKY
LOUISIANA · MARYLAND · MICHIGAN · MISSISSIPPI · MONTANA · NEBRASKA · NEVADA · NEW MEXICO · NEW YORK · NORTH DAKOTA · OHIO
OKLAHOMA · PENNSYLVANIA · SOUTH DAKOTA · TEXAS · UTAH · VIRGINIA · WEST VIRGINIA · WYOMING
ASSOCIATES: GEORGIA · IDAHO · NORTH CAROLINA · OREGON · SOUTH CAROLINA · WASHINGTON

IMPACT OF FEDERAL TAX PROPOSALS ON STRIPPER OIL WELLS
(continued)

BASIS:

- Two out of every three stripper wells are operated by independents.
- Most stripper well equipment is fully depreciated resulting in no cost basis depletion.
- The removal of percentage depletion results in the shortening of stripper well economic life by 3.75 years.
- Stripper wells operated by independent producers are exempt from windfall profits taxes.
- For every one million dollars of oil and gas revenue lost employment decreases by 91 jobs (39 direct jobs in the petroleum industry and 52 indirect jobs in other industries).
- The average wellhead crude oil price for stripper wells will be $26.00 per barrel in 1985.
- Every dollar in lost oil and gas revenue results in $0.40 less spent to drill new wells.

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SEFFECT

SUMMARY OF THE IMPACT OF THE REMOVAL OF PERCENTAGE DEPLETION FOR STRIPPER WELL PROPERTIES

EFFECT OF REMOVAL OF PERCENTAGE DEPLETION	EFFECT NATIONALLY	EFFECT TEXAS	EFFECT OKLAHOMA	
STRIPPER WELLS PREMATURELY ABANDONED	36,597	9,713	6,445	WELLS
OIL RESERVES LOST DUE TO PREMATURE ABANDONMENT	849,000,000	225,000,000	150,000,000	BARRELS
REDUCTION IN ANNUAL OIL PRODUCTION DUE TO:				
PREMATURE ABANDONMENT	78,910	20,940	15,500	BARRELS PER DAY
DECREASED 1985 DRILLING	2,400	575	400	BARRELS PER DAY
TOTAL	81,310	21,515	15,900	BARRELS PER DAY
REDUCTION IN ANNUAL OIL AND GAS SALES	$749,000,000	$198,000,000	$147,000,000	PER YEAR
REDUCTION IN ROYALTY PAYMENTS TO FARMERS, RANCHERS AND OTHER MINERAL OWNERS	$113,000,000	$30,000,000	$22,000,000	PER YEAR
REDUCTION IN SEVERANCE TAX PAYMENTS TO STATES AND OTHER GOVERNMENTAL AGENCIES	$45,000,000	$9,100,000	$10,400,000	PER YEAR
REDUCTION IN 1985 DRILLING EXPENDITURES	$300,000,000	$72,000,000	$54,000,000	PER YEAR

BASIS:

- TWO OUT OF EVERY THREE STRIPPER WELLS ARE OPERATED BY INDEPENDENTS.
- MOST STRIPPER WELLS EQUIPMENT IS FULLY DEPRECIATED RESULTING IN NO COST BASIS DEPLETION.
- THE REMOVAL OF PERCENTAGE DEPLETION RESULTS IN THE SHORTENING OF STRIPPER WELL ECONOMIC LIFE BY 3.75 YEARS.
- STRIPPER WELLS OPERATED BY INDEPENDENT PRODUCERS ARE EXEMPT FROM WINDFALL PROFITS TAXES.
- FOR EVERY ONE MILLION DOLLARS OF OIL AND GAS REVENUE LOST EMPLOYMENT DECREASES BY 91 JOBS 39 DIRECT JOBS IN THE PETROLEUM INDUSTRY AND 52 INDIRECT JOBS IN OTHER INDUSTRIES).
- THE AVERAGE WELLHEAD CRUDE OIL PRICE FOR STRIPPER WELLS WILL BE $26.00 PER BARREL IN 1985.
- EVERY DOLLAR IN LOST OIL AND GAS REVENUE RESULTS IN $0.40 LESS SPENT TO DRILL NEW WELLS.

Preliminary Evaluation
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January 8, 1985

OKSTRIP

INTERSTATE OIL COMPACT COMMISSION

P. O. BOX 53127 OKLAHOMA CITY, OKLAHOMA 73152

OKLAHOMA
STRIPPER WELL STATISTICS
1970 - 1985

	STRIPPER WELL				AVERAGE DAILY PRODUCTION PER STRIPPER WELL	STRIPPER WELL ANNUAL PRODUCTION			OKLAHOMA TOTAL	AVERAGE STRIPPER DAILY PRODUCTION			TOTAL OKLAHOMA AVERAGE	PERCENT	STRIPPER WELL RESERVES		
YEAR	NUMBER	ABANDONMENTS	ADDITIONS	ACRES	(BPD)	PRIMARY (mmBBLS)	SECONDARY (mmBBLS)	TOTAL (mmBBLS)	PRODUCTION (mmBBLS)	PRIMARY (BPD)	SECONDARY (BPD)	TOTAL (BPD)	PRODUCTION (BPD)	STRIPPER PRODUCTION	PRIMARY (mmBBLS)	SECONDARY (mmBBLS)	TOTAL (mmBBLS)
1970	55,718	2,105	994	1,248,470	4.21	34.93	50.72	85.65	223.57	95,699	138,945	234,644	612,532	38.31%	258.04	399.57	657.61
1971	54,712	2,233	1,267	1,278,105	4.05	32.43	48.46	80.89	217.75	88,860	132,773	221,632	596,586	37.15%	252.35	386.47	638.82
1972	54,788	1,044	1,686	1,321,015	3.89	28.22	49.75	77.97	201.59	77,444	135,792	213,025	550,787	38.68%	249.56	380.16	629.72
1973	57,069	1,737	3,909	1,377,592	3.56	26.18	47.93	74.11	189.40	71,726	131,315	203,041	518,915	39.13%	250.46	376.99	627.45
1974	59,017	1,869	4,686	1,440,303	3.37	24.74	48.96	73.69	173.14	67,777	134,126	201,903	474,367	42.56%	254.70	380.23	634.93
1975	58,736	1,739	650	1,442,477	3.38	24.37	48.16	72.53	165.50	66,769	131,945	198,714	448,164	44.34%	253.20	374.15	627.35
1976	53,357	881	(4,490)	1,446,780	3.76	26.87	46.59	73.46	157.12	73,404	127,306	200,708	429,284	46.75%	254.55	376.85	631.36
1977	56,239	793	3,675	1,441,880	3.62	28.36	46.04	74.40	151.41	77,703	126,134	203,837	414,833	49.14%	261.91	381.29	643.20
1978	59,976	656	4,303	1,486,660	3.39	28.60	45.58	74.18	146.18	78,344	124,877	203,220	400,499	50.74%	258.29	377.48	635.77
1979	64,093	623	5,545	1,521,118	3.21	29.85	46.15	76.00	157.37	81,782	126,438	208,220	376,351	55.33%	272.36	376.12	648.48
1980	66,128	596	1,831	1,507,072	3.30	32.68	47.26	79.95	142.28	89,540	129,134	218,429	388,751	56.19%	277.17	326.73	603.90
1981	69,781	644	4,297	1,498,620	3.26	35.55	47.70	83.25	142.26	97,394	130,685	228,079	389,504	58.54%	275.09	322.31	597.40
1982	73,328	835	4,302	1,499,904	3.52	42.81	51.43	94.24	148.27	117,293	140,890	258,184	406,225	63.56%	280.60	320.67	601.27
1983	77,729	1,093	5,494	1,587,904	3.32	42.38	52.05	94.43	155.25	116,111	142,603	258,714	425,340	60.83%	286.90	323.53	610.43
1984e	81,529	1,100	4,900	1,665,533	3.30	44.19	54.28	98.47	167.07	120,740	148,310	269,050	456,480	58.94%	298.34	336.48	634.82
1985e	75,084	6,445	0	1,533,876	3.37	41.47	50.93	92.40	161.26	113,605	139,545	253,150	441,796	57.30%	227.85	256.97	484.82

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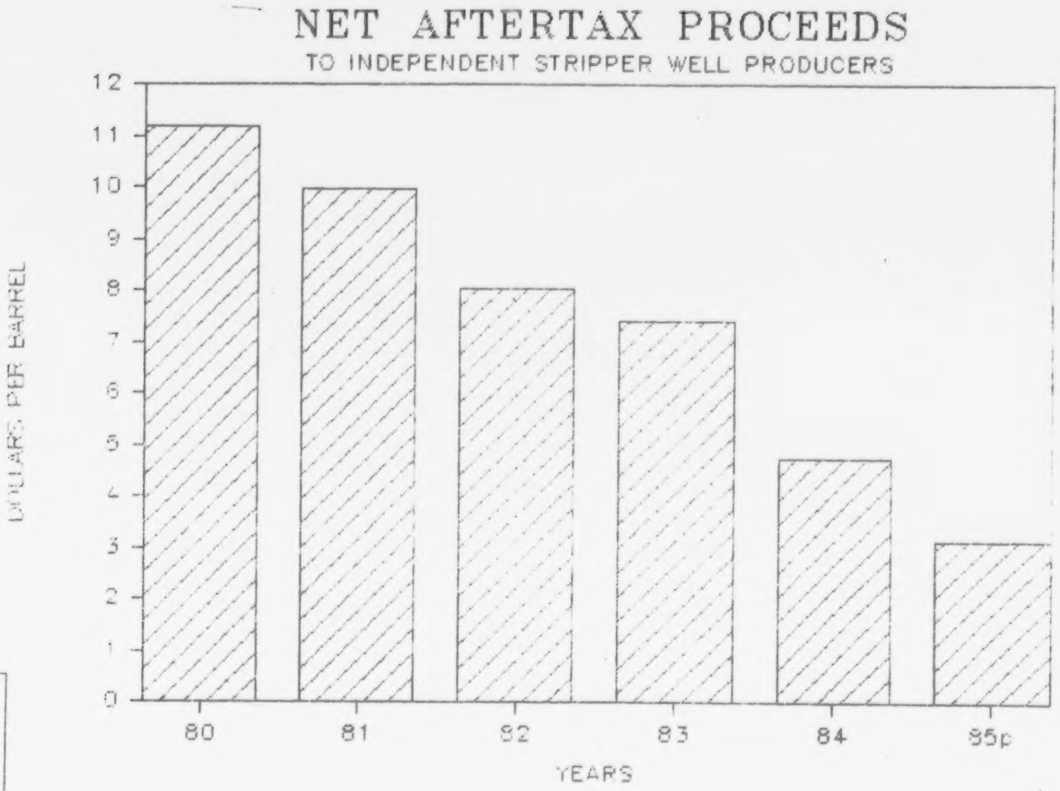

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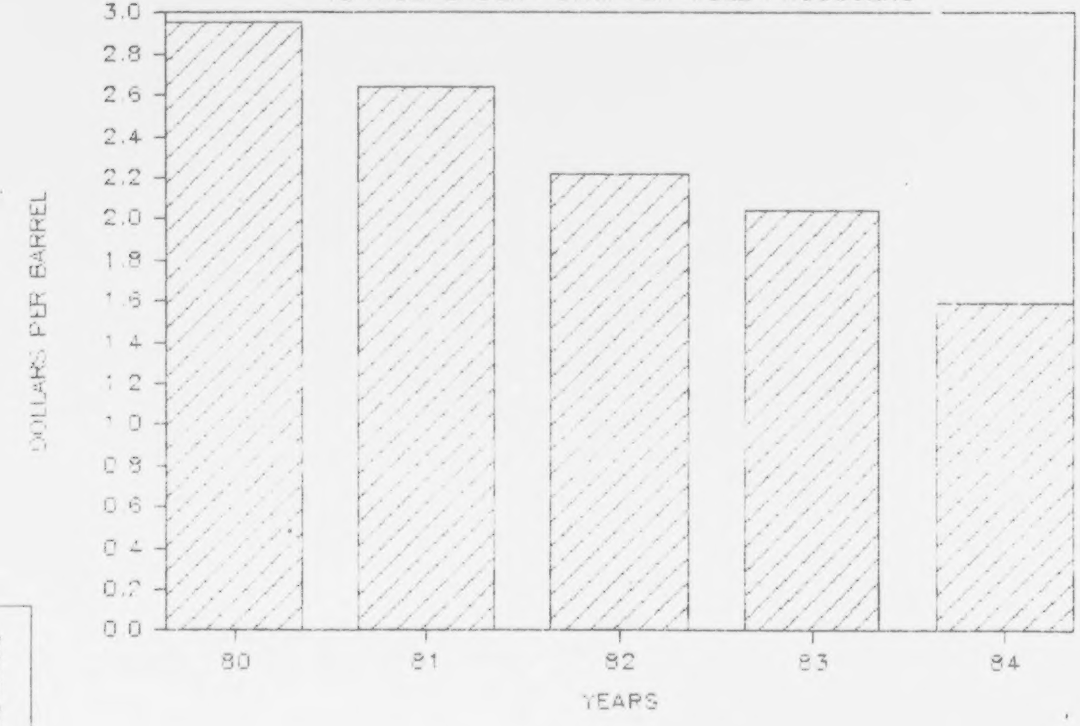
VALUE OF DEPLETION

TO INDEPENDENT STRIPPER WELL PRODUCERS



NATIONAL STRIPPER WELL SUMMARY
1954 - 1983

YEAR ENDING DECEMBER 31	NUMBER OF STRIPPER WELLS	NUMBER OF ABANDONMENTS	NUMBER OF ADDITIONS	AVERAGE DAILY PRODUCTION PER WELL (BPD)
1954	327,412	11,318	19,133	3.62
1955	345,126	9,968	27,682	3.68
1956	357,716	8,996	21,586	3.72
1957	359,803	8,651	10,738	3.62
1958	361,062	9,728	11,047	3.89
1959	376,735	11,451	27,124	3.88
1960	403,323	15,434	42,022	3.92
1961	406,102	16,977	19,756	3.99
1962	406,051	16,224	16,173	3.91
1963	401,031	14,363	9,343	3.79
1964	394,107	14,476	7,552	3.72
1965	398,299	15,456	19,648	4.05
1966	380,549	16,207	(1,543)	3.49
1967	376,851	14,986	11,288	3.63
1968	367,205	20,496	10,850	3.62
1969	358,650	15,618	7,063	3.47
1970	359,130	15,631	16,111	3.37
1971	353,696	18,421	12,987	3.58
1972	359,471	13,483	19,258	3.13
1973	355,229	13,756	9,514	2.97
1974	366,095	13,779	24,645	3.08
1975	367,872	13,478	15,255	2.93
1976	365,733	9,916	7,777	2.93
1977	368,930	9,000	12,197	2.91
1978	374,635	8,380	14,085	2.86
1979	386,310	7,668	19,343	2.79
1980	395,176	6,614	15,480	2.77
1981	409,539	7,215	21,578	2.85
1982	416,493	9,426	16,380	2.90
1993	441,501	11,032	36,040	2.87
1954-1983 MEAN	377,994	12,607	16,670	3.40

AVERAGE NUMBER OF ADDITIONS AND ABANDONMENTS 14,639

MEAN STRIPPER WELL PRODUCING LIFE 25.8 YEARS

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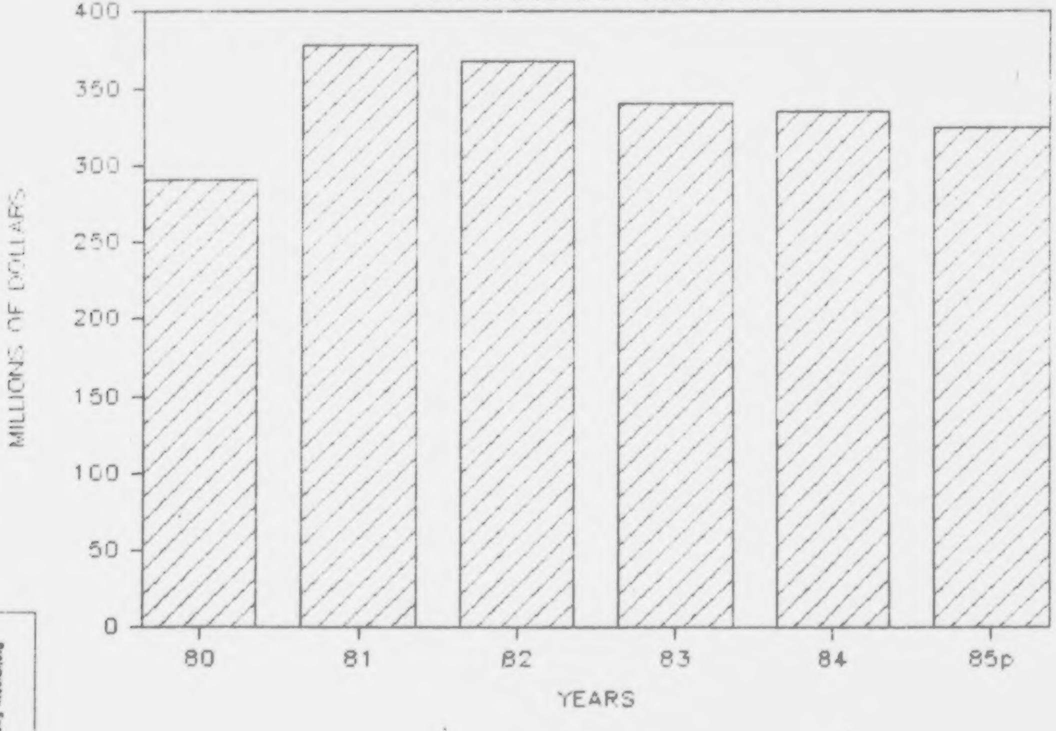
GROSS PRODUCTION TAX PROCEEDS

FOR CRUDE OIL PRODUCTION



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Proposal on State Resources,
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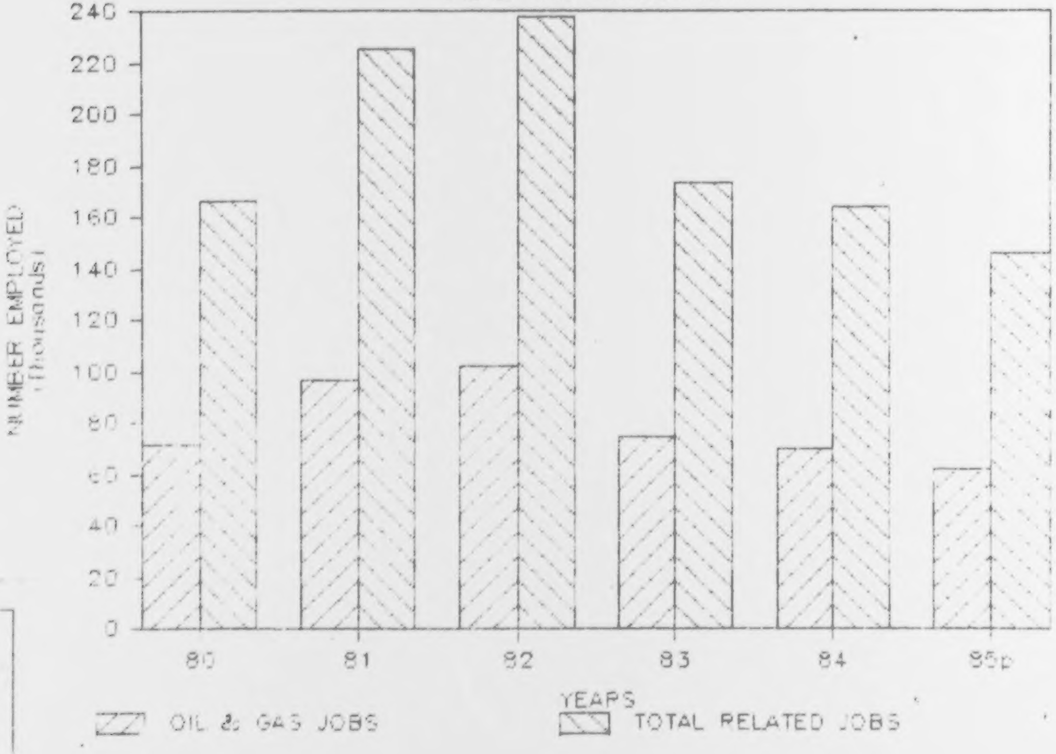
January 8, 1985

OKLAHOMA

OIL & GAS EMPLOYMENT



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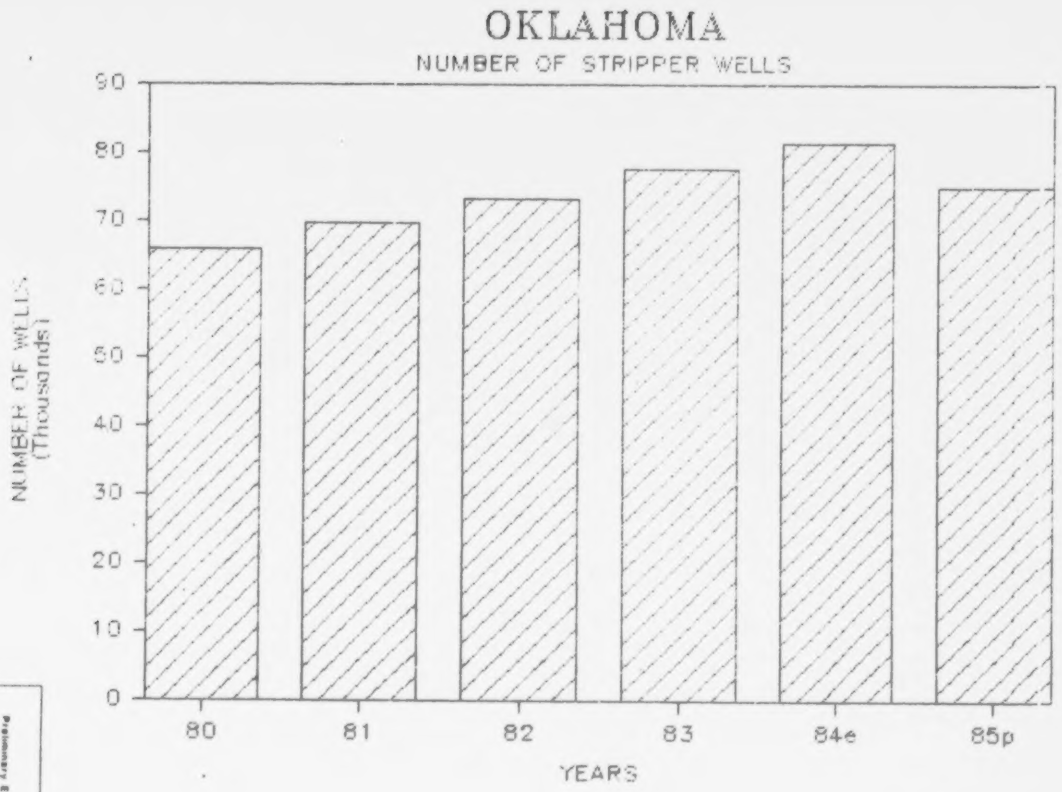

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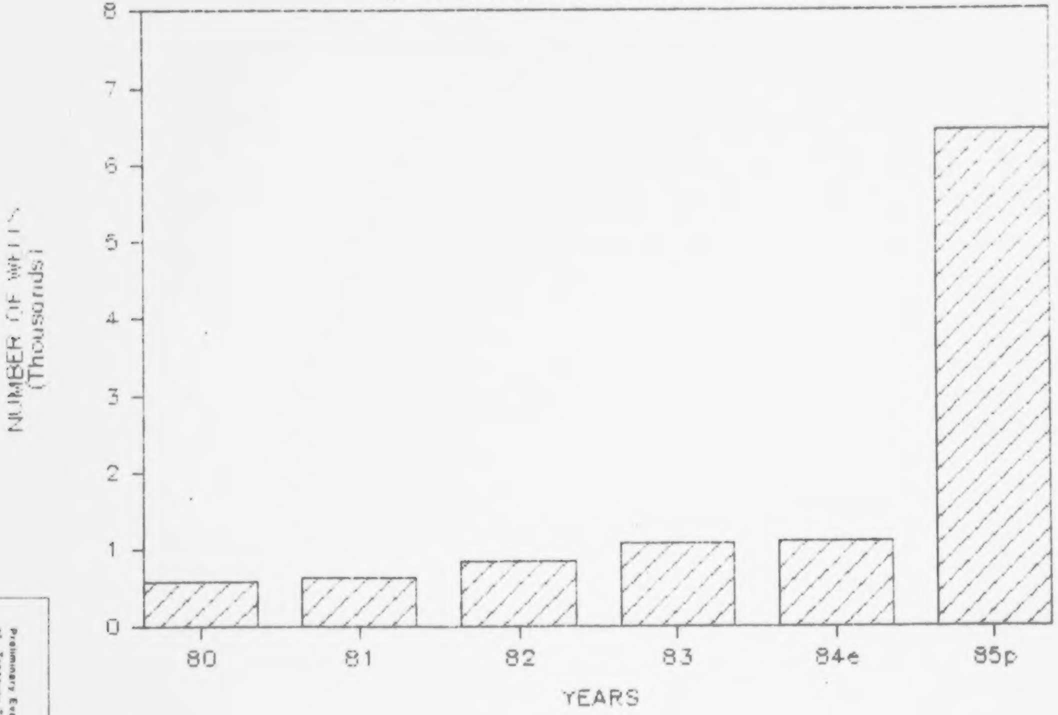
ABANDONMENT OF STRIPPER WELLS



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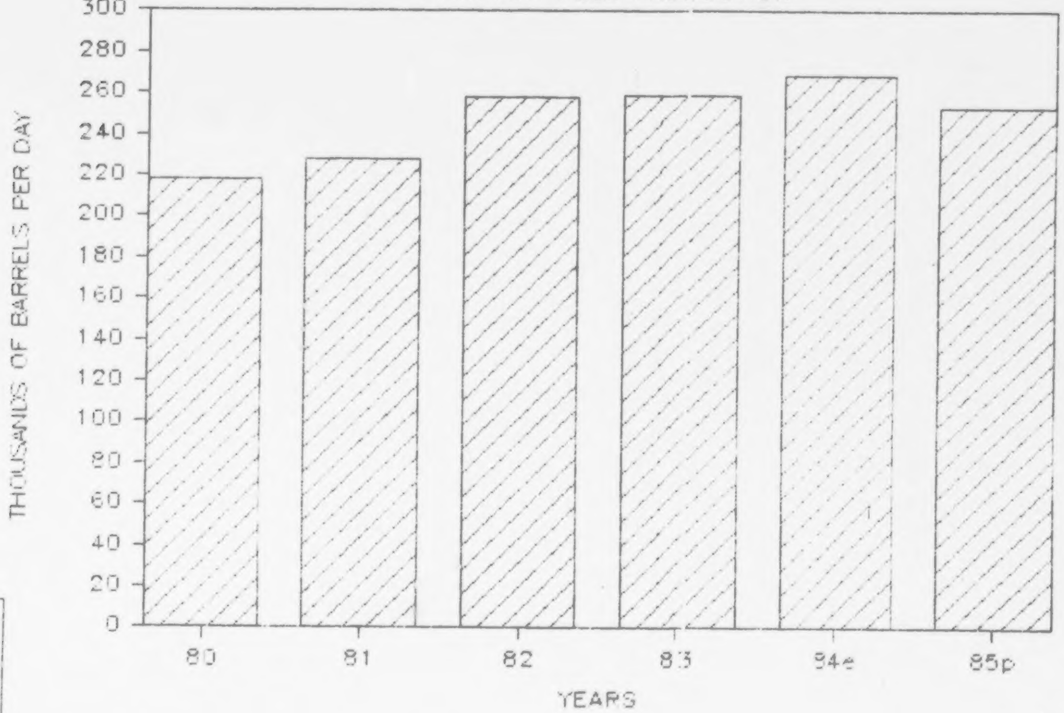
STRIPPER WELL PRODUCTION



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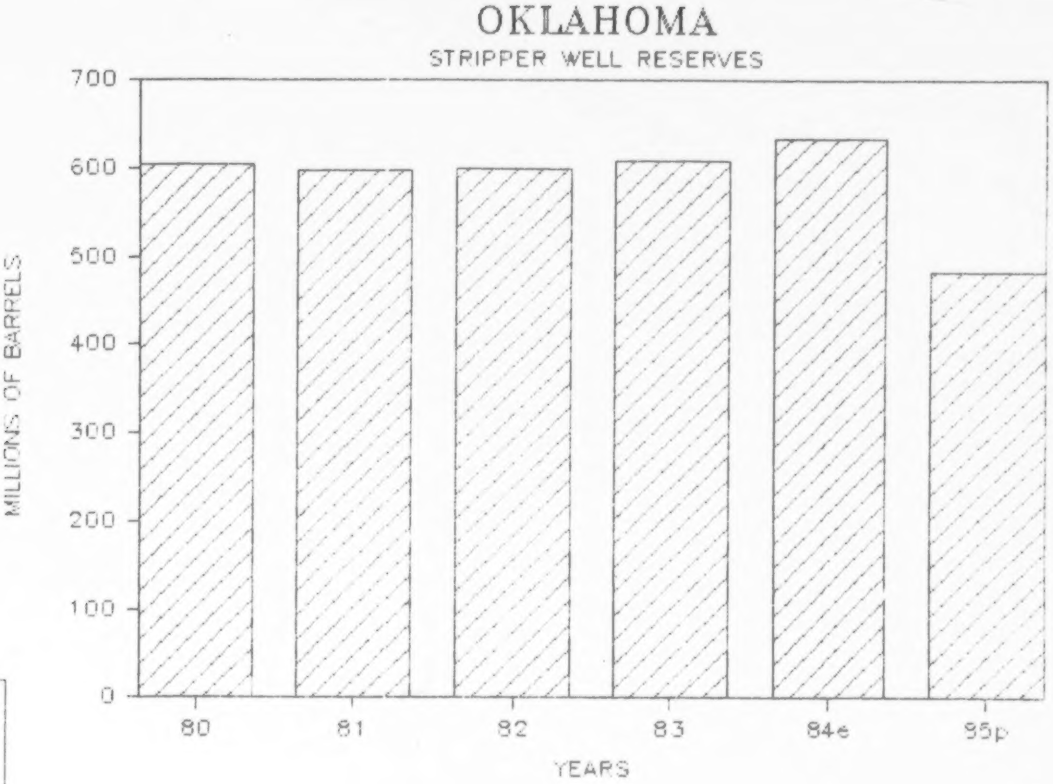

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ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPLOW

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	LOW OPERATI COST ($/BBL
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$4.
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$5.
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$5.
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$6.
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$6.9
1982	$32.81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$7.4
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$8.1
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$8.8
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$9.6

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETI ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.38	$5.38	$2.11	$2.69	$3.74	$2.69	$2.69	$1.
1975	$6.37	$6.37	$2.46	$3.18	$4.42	$3.18	$3.18	$1.2
1976	$6.17	$6.17	$2.50	$3.09	$4.34	$3.09	$3.09	$1.2
1977	$6.81	$6.81	$2.75	$3.40	$4.78	$3.40	$3.40	$1.3
1978	$6.58	$6.58	$2.82	$3.29	$4.70	$3.29	$3.29	$1.4
1979	$13.44	$13.44	$4.60	$6.72	$9.02	$6.72	$6.72	$2.3
1980	$12.26	$18.46	$5.92	$6.13	$12.19	$6.13	$9.23	$2.
1981	$12.35	$17.56	$5.27	$6.17	$11.42	$6.17	$8.78	$2.
1982	$11.71	$15.48	$4.43	$5.86	$9.96	$5.86	$7.74	$2.2
1983	$10.30	$15.53	$4.08	$5.15	$9.81	$5.15	$7.77	$2.
1984	$9.38	$12.24	$3.41	$4.69	$7.83	$4.69	$6.12	$1.7
1985	$8.96	$10.88	$3.32	$4.48	$7.10	$4.48	$5.44	$1.6

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ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPMID

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL. PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	MID OPERATIN COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.7
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.9
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$5.
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$6.4
1979	$13.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$7.4
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$8.
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$9.7
1982	$32.81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$11.
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$12.
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$14.7
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$16.

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETIC ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.19	$5.19	$2.11	$2.59	$3.65	$2.59	$2.59	$1.
1975	$6.14	$6.14	$2.46	$3.07	$4.30	$3.07	$3.07	$1.
1976	$5.66	$5.66	$2.50	$2.83	$4.08	$2.83	$2.83	$1.
1977	$6.01	$6.01	$2.75	$3.00	$4.38	$3.00	$3.00	$1.
1978	$5.47	$5.47	$2.82	$2.73	$4.14	$2.73	$2.73	$1.
1979	$12.00	$12.00	$4.60	$6.00	$8.30	$6.00	$6.00	$2.
1980	$10.28	$16.47	$5.92	$5.14	$11.19	$5.14	$8.24	$2.
1981	$9.50	$14.72	$5.27	$4.75	$9.99	$4.75	$7.36	$2.
1982	$7.91	$11.68	$4.43	$3.96	$8.06	$3.96	$5.14	$2.
1983	$5.58	$10.82	$4.08	$2.79	$7.45	$2.79	$5.41	$2.
1984	$3.49	$6.35	$3.17	$1.74	$4.76	$1.74	$3.17	$1.
1985	$1.64	$3.57	$1.78	$0.82	$2.68	$0.82	$1.78	$0.

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ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPHIGH

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	HIGH OPERATIN COST ($/BBL
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.8
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.5
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$5.4
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$5.4
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$7.6
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$9.
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$10.
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$12.7
1982	$32.81	$32.75	$20.20	$25.27	$28.44	$4.35	$1.75	$15.1
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$17.9
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$21.2
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$25.2

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION: MAJOR ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION: INDEPENDENT ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION: MAJOR ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION: INDEPENDENT ($/BBL)	NET EFFECT OF REMOVAL OF DEPLETIO ($/BBL
1974	$5.06	$5.06	$2.11	$2.53	$3.59	$2.53	$2.53	$1.0
1975	$5.85	$5.85	$2.46	$2.92	$4.15	$2.92	$2.92	$1.2
1976	$5.14	$5.14	$2.50	$2.57	$3.82	$2.57	$2.57	$1.2
1977	$5.21	$5.21	$2.75	$2.60	$3.98	$2.60	$2.60	$1.3
1978	$4.30	$4.30	$2.82	$2.15	$3.56	$2.15	$2.15	$1.4
1979	$10.36	$10.36	$4.60	$5.18	$7.48	$5.18	$5.18	$2.3
1980	$8.05	$14.25	$5.92	$4.03	$10.08	$4.03	$7.12	$2.9
1981	$6.54	$11.75	$5.27	$3.27	$8.51	$3.27	$5.87	$2.6
1982	$4.01	$7.78	$3.89	$2.01	$5.83	$2.01	$3.89	$1.9
1983	$0.52	$5.76	$2.88	$0.26	$4.32	$0.26	$2.88	$1.4
1984	($3.02)	($0.16)	($0.08)	($1.51)	($0.12)	($1.51)	($0.08)	($0.0
1985	($6.65)	($4.72)	($2.36)	($3.32)	($3.54)	($3.32)	($2.36)	($1.1

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SEFFECT

SUMMARY OF THE IMPACT OF THE REMOVAL OF PERCENTAGE DEPLETION FOR STRIPPER WELL PROPERTIES

EFFECT OF REMOVAL OF PERCENTAGE DEPLETION	EFFECT NATIONALLY	EFFECT TEXAS	EFFECT OKLAHOMA	
STRIPPER WELLS PREMATURELY ABANDONED	36,597	9,713	6,445	WELLS
OIL RESERVES LOST DUE TO PREMATURE ABANDONMENT	849,000,000	225,000,000	150,000,000	BARRELS
REDUCTION IN ANNUAL OIL PRODUCTION DUE TO:				
PREMATURE ABANDONMENT	78,910	20,940	15,500	BARRELS PER DAY
DECREASED 1985 DRILLING	2,400	575	400	BARRELS PER DAY
TOTAL	81,310	21,515	15,900	BARRELS PER DAY
REDUCTION IN ANNUAL OIL AND GAS SALES	$749,000,000	$198,000,000	$147,000,000	PER YEAR
REDUCTION IN ROYALTY PAYMENTS TO FARMERS, RANCHERS AND OTHER MINERAL OWNERS	$113,000,000	$30,000,000	$22,000,000	PER YEAR
REDUCTION IN SEVERANCE TAX PAYMENTS TO STATES AND OTHER GOVERNMENTAL AGENCIES	$45,000,000	$9,100,000	$10,400,000	PER YEAR
REDUCTION IN 1985 DRILLING EXPENDITURES	$300,000,000	$72,000,000	$54,000,000	PER YEAR

BASIS:

- TWO OUT OF EVERY THREE STRIPPER WELLS ARE OPERATED BY INDEPENDENTS.
- MOST STRIPPER WELLS EQUIPMENT IS FULLY DEPRECIATED RESULTING IN NO COST BASIS DEPLETION.
- THE REMOVAL OF PERCENTAGE DEPLETION RESULTS IN THE SHORTENING OF STRIPPER WELL ECONOMIC LIFE BY 3.75 YEARS.
- STRIPPER WELLS OPERATED BY INDEPENDENT PRODUCERS ARE EXEMPT FROM WINDFALL PROFITS TAXES.
- FOR EVERY ONE MILLION DOLLARS OF OIL AND GAS REVENUE LOST EMPLOYMENT DECREASES BY 91 JOBS 39 DIRECT JOBS IN THE PETROLEUM INDUSTRY AND 52 INDIRECT JOBS IN OTHER INDUSTRIES).
- THE AVERAGE WELLHEAD CRUDE OIL PRICE FOR STRIPPER WELLS WILL BE $26.00 PER BARREL IN 1985.
- EVERY DOLLAR IN LOST OIL AND GAS REVENUE RESULTS IN $0.40 LESS SPENT TO DRILL NEW WELLS.

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NATSTRIP

INTERSTATE OIL COMPACT COMMISSION
P. O. BOX 53127 OKLAHOMA CITY, OKLAHOMA 73152

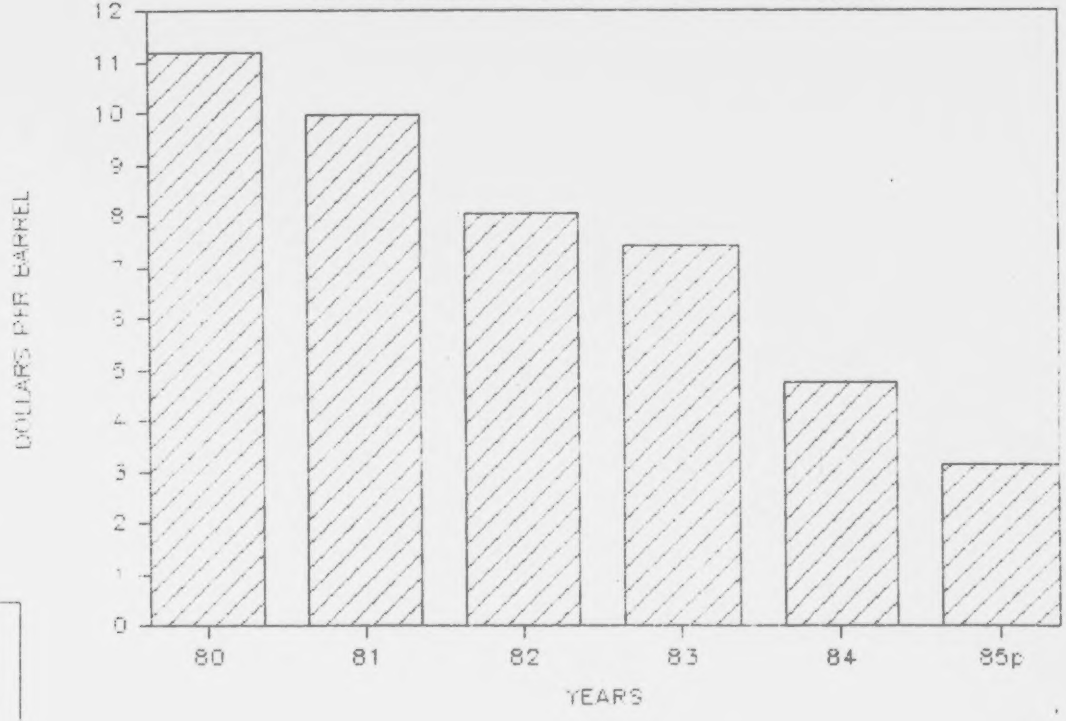
NATIONAL
STRIPPER WELL STATISTICS
1970 - 1985

YEAR	STRIPPER WELL NUMBER	STRIPPER WELL ABANDONMENTS	STRIPPER WELL ADDITIONS	STRIPPER WELL ACRES	AVERAGE DAILY PRODUCTION PER STRIPPER WELL (BPD)	TOTAL STRIPPER WELL ANNUAL PRODUCTION (mmBBLS)	NATIONAL* TOTAL PRODUCTION (mmBBLS)	TOTAL STRIPPER WELL AVERAGE DAILY PRODUCTION (BPD)	TOTAL NATIONAL AVERAGE PRODUCTION (BPD)	PERCENT STRIPPER PRODUCTION	STRIPPER WELL RESERVES PRIMARY (mmBBLS)	STRIPPER WELL RESERVES SECONDARY (mmBBLS)	STRIPPER WELL RESERVES TOTAL (mmBBLS)
1970	359,150	15,631	16,111	8,760,454	3.37	441.29	3,375.90	1,209,006	9,249,033	13.07%	2761.22	2197.99	4959.21
1971	353,696	18,421	12,987	8,761,001	3.50	423.32	3,223.46	1,159,786	8,831,236	13.13%	2659.90	2161.46	4821.35
1972	359,471	13,483	19,258	8,629,986	3.13	411.92	3,345.21	1,125,478	9,159,915	12.31%	2855.86	2026.04	4881.90
1973	355,229	13,756	9,514	8,741,307	2.97	385.68	3,206.44	1,056,667	8,784,753	12.03%	2981.09	1877.18	4858.97
1974	366,095	13,779	24,645	8,964,465	3.08	411.94	3,048.96	1,128,592	8,350,836	13.51%	3020.19	1866.26	4886.44
1975	367,072	13,478	15,255	9,210,949	2.93	394.16	2,804.60	1,079,098	7,684,063	14.05%	3004.29	1841.43	4845.72
1976	365,733	9,916	7,777	9,299,620	2.93	392.19	2,730.86	1,071,559	7,461,366	14.36%	2868.00	2008.32	4876.32
1977	368,930	9,000	12,197	9,423,161	2.91	392.53	2,672.02	1,075,430	7,322,795	14.69%	2901.35	2012.67	4914.03
1978	374,635	8,380	14,085	8,931,717	2.86	391.63	2,552.07	1,072,968	6,991,904	15.35%	2892.65	2107.25	4999.90
1979	386,310	7,668	19,343	9,154,003	2.79	394.41	2,420.48	1,080,562	6,631,444	16.29%	3003.95	2165.19	5169.14
1980	395,176	6,614	15,480	9,664,125	2.77	401.10	2,461.16	1,095,089	6,724,309	16.30%	3052.30	2136.24	5184.01
1981	409,539	7,215	21,578	9,683,564	2.85	426.56	2,137.97	1,168,560	5,857,458	19.95%	2620.59	1798.37	4426.96
1982	416,493	9,426	16,388	9,720,451	2.98	441.95	2,072.51	1,210,825	5,678,107	21.32%	2594.03	1860.37	4454.40
1983	441,501	11,032	36,040	10,411,234	2.87	462.01	2,125.02	1,265,790	5,821,973	21.74%	2579.65	2011.16	4590.81
1984e	457,402	10,229	26,216	10,788,089	2.87	480.55	2,125.02	1,316,571	5,821,973	22.61%	2683.13	2091.85	4774.98
1985p	420,085	36,587	0	9,925,079	2.93	450.87	2,095.34	1,235,261	5,740,663	21.52%	2205.82	1719.72	3925.53

* TOTAL PRODUCTION FROM THE STATES INCLUDED IN THE NATIONAL STRIPPER WELL SURVEY, 1971-1984

NET AFTERTAX PROCEEDS

TO INDEPENDENT STRIPPER WELL PRODUCERS



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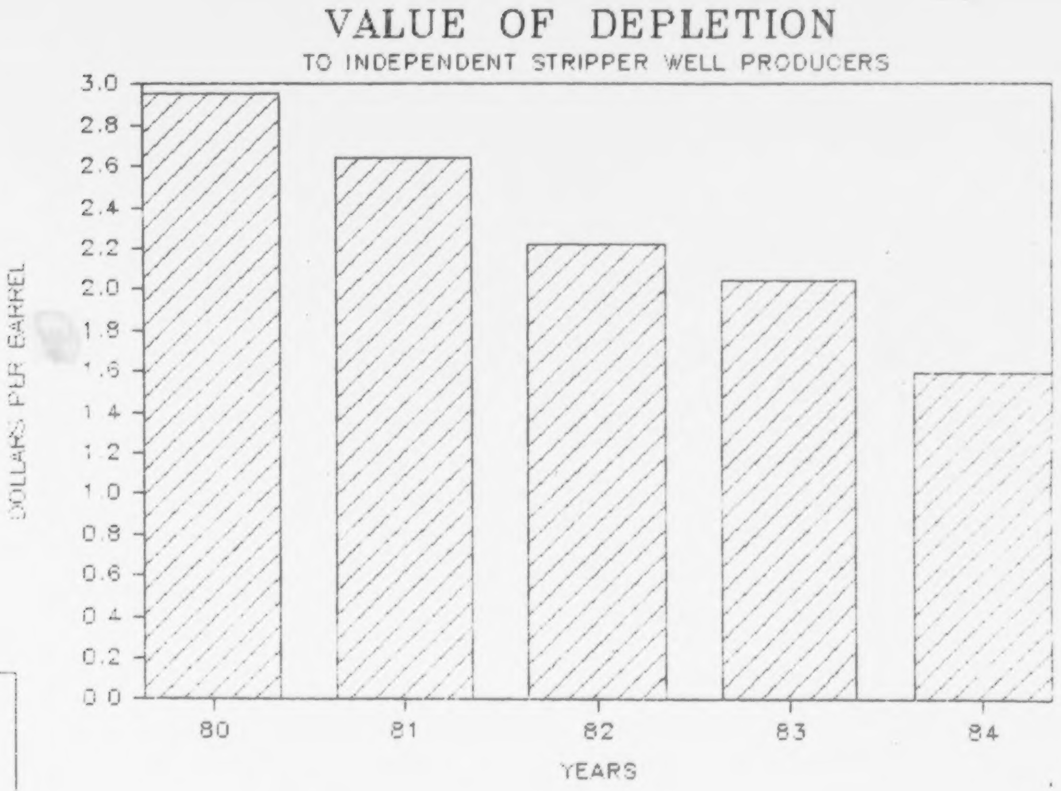

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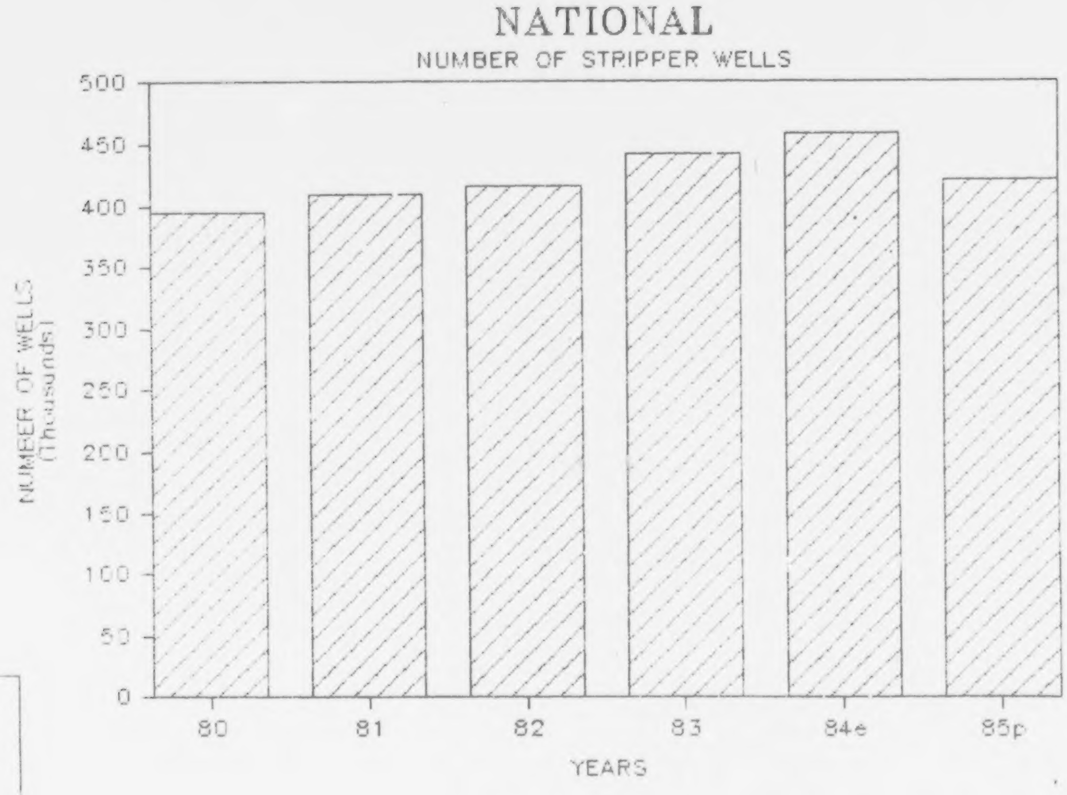

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NATIONAL STRIPPER WELL SUMMARY
1954 - 1983

YEAR ENDING DECEMBER 31	NUMBER OF STRIPPER WELLS	NUMBER OF ABANDONMENTS	NUMBER OF ADDITIONS	AVERAGE DAILY PRODUCTION PER WELL (BPD)
1954	327,412	11,318	19,133	3.62
1955	345,126	9,968	27,682	3.68
1956	357,716	8,996	21,586	3.72
1957	359,803	8,651	10,738	3.62
1958	361,062	9,788	11,047	3.89
1959	376,735	11,451	27,124	3.88
1960	403,323	15,434	42,022	3.92
1961	406,102	16,977	19,756	3.99
1962	406,051	16,224	16,173	3.91
1963	401,031	14,363	9,343	3.79
1964	394,107	14,476	7,552	3.72
1965	398,299	15,456	19,648	4.05
1966	380,549	16,207	(1,543)	3.49
1967	376,851	14,986	11,288	3.63
1968	367,205	20,496	10,850	3.62
1969	358,650	15,618	7,063	3.47
1970	359,130	15,631	16,111	3.37
1971	353,696	18,421	12,987	3.58
1972	359,471	13,483	19,258	3.13
1973	355,229	13,756	9,514	2.97
1974	366,095	13,779	24,645	3.08
1975	367,872	13,478	15,255	2.93
1976	365,733	9,916	7,777	2.93
1977	368,930	9,000	12,197	2.91
1978	374,635	8,380	14,085	2.86
1979	386,310	7,668	19,343	2.79
1980	395,176	6,614	15,480	2.77
1981	409,539	7,215	21,578	2.85
1982	416,493	9,426	16,380	2.90
1983	441,501	11,032	36,040	2.87
1954-1983 MEAN	377,994	12,607	16,670	3.40

AVERAGE NUMBER OF ADDITIONS AND ABANDONMENTS 14,639

MEAN STRIPPER WELL PRODUCING LIFE 25.8 YEARS

Preliminary Evaluation
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ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPLOW

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	LOW OPERATING COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.53
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.04
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.39
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$4.83
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$5.35
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$5.97
1980	$27.55	$37.63	$17.18	$25.44	$31.64	$4.75	$1.91	$6.53
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$6.93
1982	$32.81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$7.42
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$8.16
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$8.89
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$9.65

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETION ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.38	$5.38	$2.11	$2.69	$3.74	$2.69	$2.69	$1.05
1975	$6.37	$6.37	$2.46	$3.18	$4.42	$3.18	$3.18	$1.23
1976	$6.17	$6.17	$2.50	$3.09	$4.34	$3.09	$3.09	$1.25
1977	$6.81	$6.81	$2.75	$3.40	$4.78	$3.40	$3.40	$1.38
1978	$6.58	$6.58	$2.82	$3.29	$4.70	$3.29	$3.29	$1.41
1979	$13.44	$13.44	$4.60	$6.72	$9.02	$6.72	$6.72	$2.30
1980	$12.26	$18.46	$5.92	$6.13	$12.19	$6.13	$9.23	$2.96
1981	$12.35	$17.56	$5.27	$6.17	$11.42	$6.17	$8.78	$2.64
1982	$11.71	$15.48	$4.43	$5.86	$9.96	$5.86	$7.74	$2.22
1983	$10.30	$15.53	$4.08	$5.15	$9.81	$5.15	$7.77	$2.04
1984	$9.38	$12.24	$3.41	$4.69	$7.83	$4.69	$6.12	$1.71
1985	$8.96	$10.88	$3.32	$4.48	$7.10	$4.48	$5.44	$1.66

ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPMID

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	MID OPERATING COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.72
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.27
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.90
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$5.63
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$6.46
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$7.42
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$8.51
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$9.77
1982	$32.81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$11.22
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$12.88
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$14.78
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$16.97

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETION ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.19	$5.19	$2.11	$2.59	$3.65	$2.59	$2.59	$1.05
1975	$6.14	$6.14	$2.46	$3.07	$4.30	$3.07	$3.07	$1.23
1976	$5.66	$5.66	$2.50	$2.83	$4.08	$2.83	$2.83	$1.25
1977	$6.01	$6.01	$2.75	$3.00	$4.38	$3.00	$3.00	$1.38
1978	$5.47	$5.47	$2.82	$2.73	$4.14	$2.73	$2.73	$1.41
1979	$12.00	$12.00	$4.60	$6.00	$8.30	$6.00	$6.00	$2.30
1980	$10.28	$16.47	$5.92	$5.14	$11.19	$5.14	$8.24	$2.96
1981	$9.50	$14.72	$5.27	$4.75	$9.99	$4.75	$7.36	$2.64
1982	$7.91	$11.68	$4.43	$3.96	$8.06	$3.96	$5.84	$2.22
1983	$5.58	$10.82	$4.08	$2.79	$7.45	$2.79	$5.41	$2.04
1984	$3.49	$6.35	$3.17	$1.74	$4.76	$1.74	$3.17	$1.59
1985	$1.64	$3.57	$1.78	$0.82	$2.68	$0.82	$1.78	$0.89

ESTIMATED PRE-TAX AND AFTER TAX PROCEEDS
TO THE PRODUCER WITH AND WITHOUT PERCENTAGE DEPLETION

STRIPHIGH

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	HIGH OPERATING COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.85
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.56
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$5.42
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$6.43
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$7.63
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$9.05
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$10.74
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$12.74
1982	$32.81	$32.75	$20.20	$25.27	$28.99	$4.35	$1.75	$15.12
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$17.94
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$21.29
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$25.26

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETION ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.06	$5.06	$2.11	$2.53	$3.59	$2.53	$2.53	$1.05
1975	$5.85	$5.85	$2.46	$2.92	$4.15	$2.92	$2.92	$1.23
1976	$5.14	$5.14	$2.50	$2.57	$3.82	$2.57	$2.57	$1.25
1977	$5.21	$5.21	$2.75	$2.60	$3.98	$2.60	$2.60	$1.38
1978	$4.30	$4.30	$2.82	$2.15	$3.56	$2.15	$2.15	$1.41
1979	$10.36	$10.36	$4.60	$5.18	$7.48	$5.18	$5.18	$2.30
1980	$8.05	$14.25	$5.92	$4.03	$10.08	$4.03	$7.12	$2.96
1981	$6.54	$11.75	$5.27	$3.27	$8.51	$3.27	$5.87	$2.64
1982	$4.01	$7.78	$3.89	$2.01	$5.83	$2.01	$3.89	$1.94
1983	$0.52	$5.76	$2.88	$0.26	$4.32	$0.26	$2.88	$1.44
1984	($3.02)	($0.16)	($0.08)	($1.51)	($0.12)	($1.51)	($0.08)	($0.04)
1985	($6.65)	($4.72)	($2.36)	($3.32)	($3.54)	($3.32)	($2.36)	($1.18)

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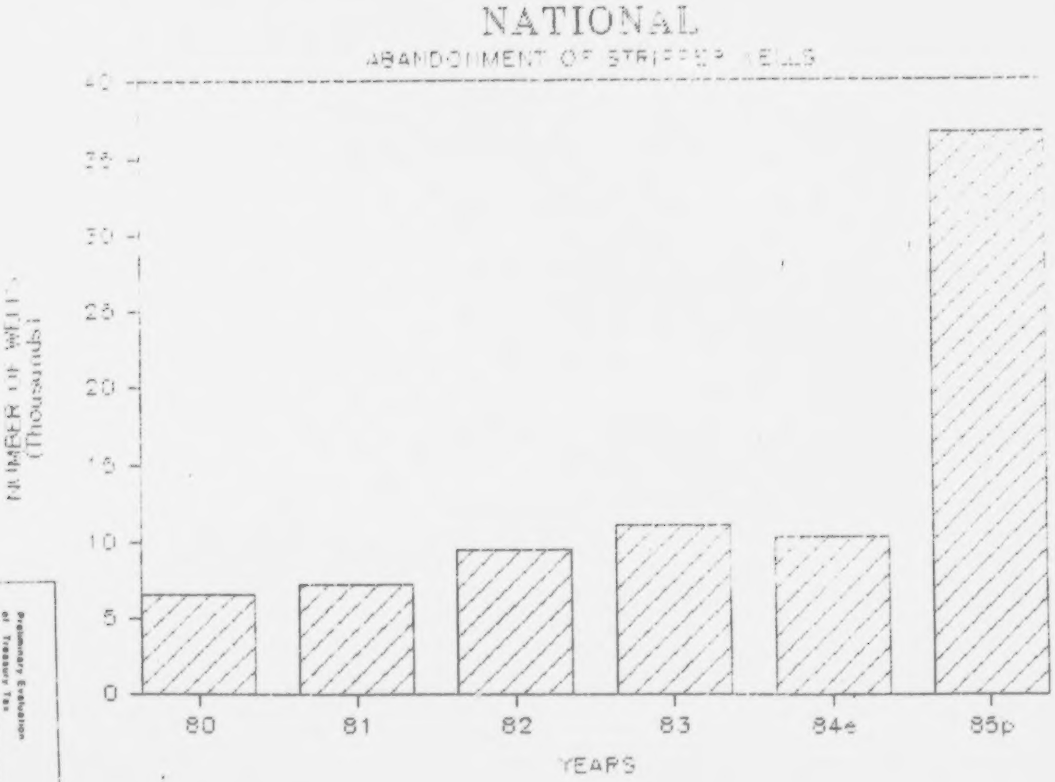

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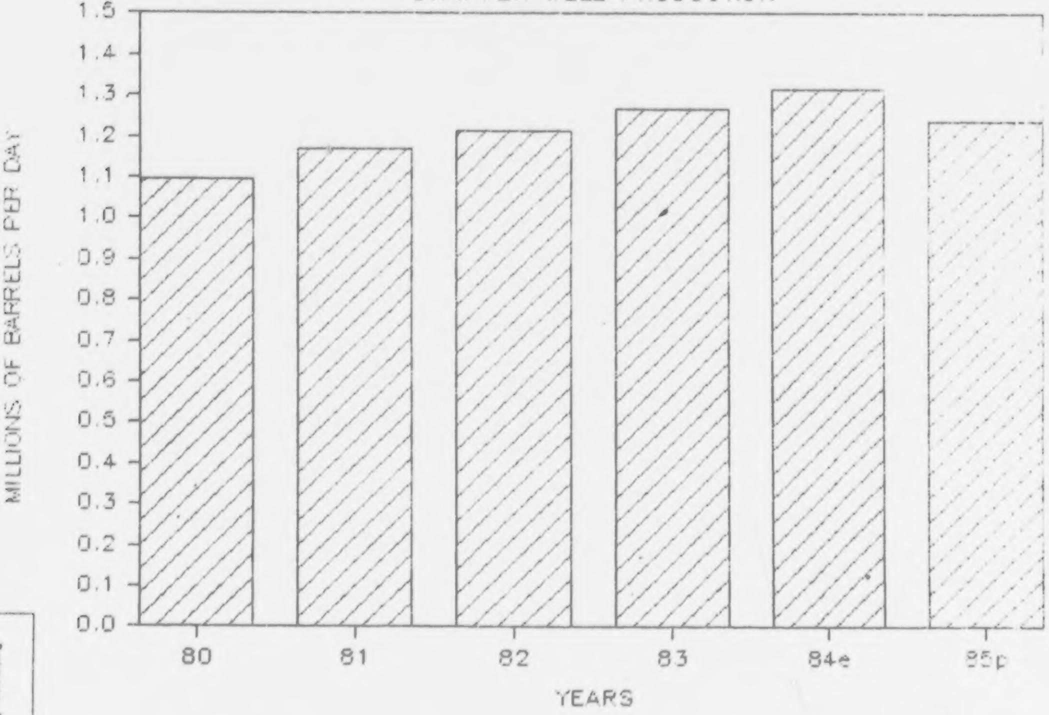
NATIONAL

STRIPPER WELL PRODUCTION



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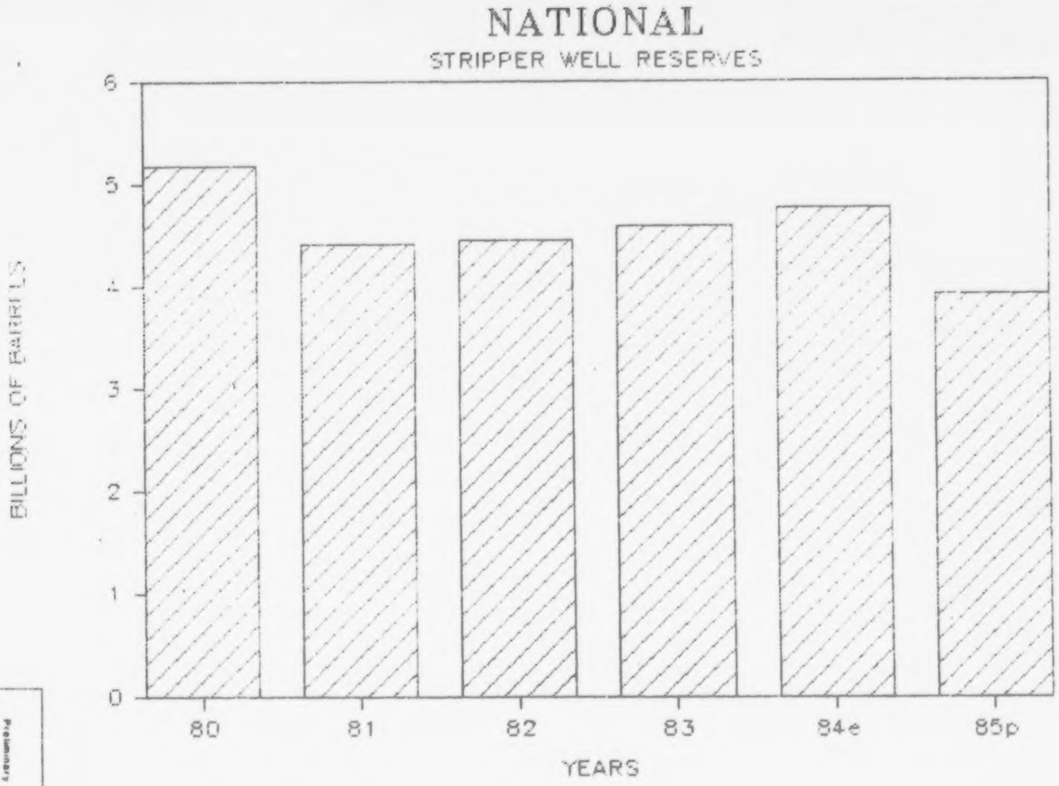

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INTERSTATE OIL COMPACT COMMISSION
P. O. BOX 53127 OKLAHOMA CITY, OKLAHOMA 73152

TXSTRIP

TEXAS
STRIPPER WELL STATISTICS
1970 - 1985

	STRIPPER WELL				AVERAGE DAILY PRODUCTION PER STRIPPER WELL	TOTAL STRIPPER WELL ANNUAL PRODUCTION	TEXAS TOTAL PRODUCTION	TOTAL STRIPPER WELL AVERAGE DAILY PRODUCTION	TOTAL TEXAS AVERAGE PRODUCTION	PERCENT STRIPPER PRODUCTION	STRIPPER WELL RESERVES		
YEAR	NUMBER	ABANDONMENTS	ADDITIONS	ACRES	(BPD)	(mmBBLS)	(mmBBLS)	(BPD)	(BPD)		PRIMARY (mmBBLS)	SECONDARY (mmBBLS)	TOTAL (mmBBLS)
1970	85,117	3,860	398	2,393,935	3.98	123.74	1,207.56	339,004	3,308,375	10.25%	1202.74	762.37	1965.11
1971	84,950	4,265	4,098	2,632,878	3.95	122.42	1,182.52	335,398	3,239,773	10.35%	1171.11	746.06	1917.16
1972	83,666	3,682	2,398	2,566,174	3.81	116.64	1,290.52	318,677	3,525,997	9.04%	1108.00	729.36	1837.36
1973	82,302	3,884	2,520	2,380,635	3.74	112.75	1,256.97	307,326	3,443,762	8.97%	1084.26	687.00	1771.26
1974	87,412	4,608	9,718	2,470,395	3.96	126.39	1,224.95	346,266	3,355,962	10.32%	1208.55	[illegible]	1888.01
1975	89,027	5,716	7,331	2,619,393	3.88	126.03	1,185.60	345,256	3,248,447	10.63%	1201.88	676.69	1878.56
1976	91,498	3,177	5,648	2,627,364	3.87	129.70	1,155.96	354,371	3,152,044	11.20%	1064.96	839.52	1904.48
1977	92,887	3,057	4,446	2,642,234	3.77	127.89	1,101.16	350,374	3,016,814	11.61%	1053.92	828.00	1881.92
1978	96,713	2,599	6,425	2,669,700	3.72	131.21	1,046.97	359,482	2,851,962	12.53%	1066.75	909.15	1975.90
1979	98,407	2,348	4,042	2,678,610	3.80	136.77	978.15	374,720	2,679,874	13.96%	1051.28	930.38	1981.66
1980	103,594	1,930	7,645	2,709,038	3.74	141.83	931.08	387,500	2,543,929	15.23%	1127.09	943.14	2070.23
1981	107,596	1,948	5,950	2,767,496	3.72	145.94	897.57	399,835	2,459,104	16.26%	1139.53	895.34	2034.87
1982	111,671	2,920	6,995	2,786,760	3.53	143.93	871.78	394,325	2,388,438	16.51%	1146.65	938.17	2084.82
1983	117,178	3,900	9,407	2,841,760	3.59	153.69	849.07	421,064	2,326,225	18.10%	1073.13	1031.05	2104.18
1984e	121,969	3,450	8,241	2,957,954	3.59	159.82	826.96	437,869	2,265,631	19.33%	1115.96	1072.20	2188.16
1985p	112,256	9,713	0	2,722,393	3.71	151.97	819.10	416,351	2,244,113	18.55%	1014.98	975.18	1990.16

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SEFFECT

SUMMARY OF THE IMPACT OF THE REMOVAL OF PERCENTAGE DEPLETION FOR STRIPPER WELL PROPERTIES

EFFECT OF REMOVAL OF PERCENTAGE DEPLETION	EFFECT NATIONALLY	EFFECT TEXAS	EFFECT OKLAHOMA	
STRIPPER WELLS PREMATURELY ABANDONED	36,597	9,713	6,445	WELLS
OIL RESERVES LOST DUE TO PREMATURE ABANDONMENT	849,000,000	225,000,000	150,000,000	BARRELS
REDUCTION IN ANNUAL OIL PRODUCTION DUE TO:				
PREMATURE ABANDONMENT	78,910	20,940	15,500	BARRELS PER DAY
DECREASED 1985 DRILLING	2,400	575	400	BARRELS PER DAY
TOTAL	81,310	21,515	15,900	BARRELS PER DAY
REDUCTION IN ANNUAL OIL AND GAS SALES	$749,000,000	$198,000,000	$147,000,000	PER YEAR
REDUCTION IN ROYALTY PAYMENTS TO FARMERS, RANCHERS AND OTHER MINERAL OWNERS	$113,000,000	$30,000,000	$22,000,000	PER YEAR
REDUCTION IN SEVERANCE TAX PAYMENTS TO STATES AND OTHER GOVERNMENTAL AGENCIES	$45,000,000	$9,100,000	$10,400,000	PER YEAR
REDUCTION IN 1985 DRILLING EXPENDITURES	$300,000,000	$72,000,000	$54,000,000	PER YEAR

BASIS:

- TWO OUT OF EVERY THREE STRIPPER WELLS ARE OPERATED BY INDEPENDENTS.
- MOST STRIPPER WELLS EQUIPMENT IS FULLY DEPRECIATED RESULTING IN NO COST BASIS DEPLETION.
- THE REMOVAL OF PERCENTAGE DEPLETION RESULTS IN THE SHORTENING OF STRIPPER WELL ECONOMIC LIFE BY 3.75 YEARS.
- STRIPPER WELLS OPERATED BY INDEPENDENT PRODUCERS ARE EXEMPT FROM WINDFALL PROFITS TAXES.
- FOR EVERY ONE MILLION DOLLARS OF OIL AND GAS REVENUE LOST EMPLOYMENT DECREASES BY 91 JOBS 39 DIRECT JOBS IN THE PETROLEUM INDUSTRY AND 52 INDIRECT JOBS IN OTHER INDUSTRIES).
- THE AVERAGE WELLHEAD CRUDE OIL PRICE FOR STRIPPER WELLS WILL BE $26.00 PER BARREL IN 1985.
- EVERY DOLLAR IN LOST OIL AND GAS REVENUE RESULTS IN $0.40 LESS SPENT TO DRILL NEW WELLS.

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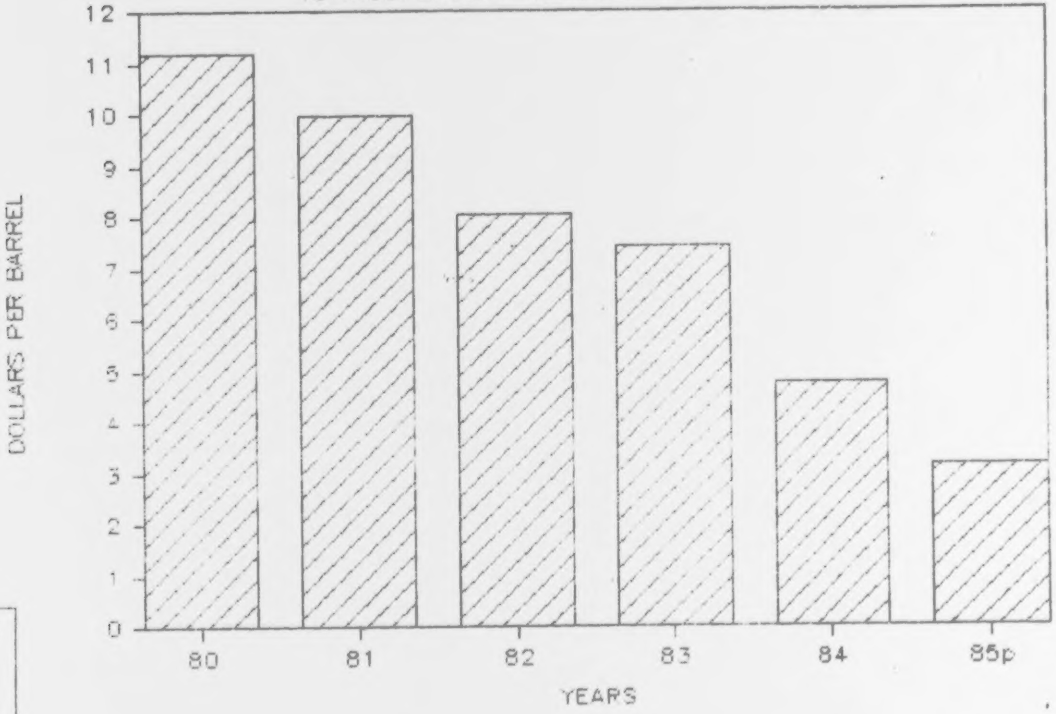
NET AFTERTAX PROCEEDS

TO INDEPENDENT STRIPPER WELL PRODUCERS



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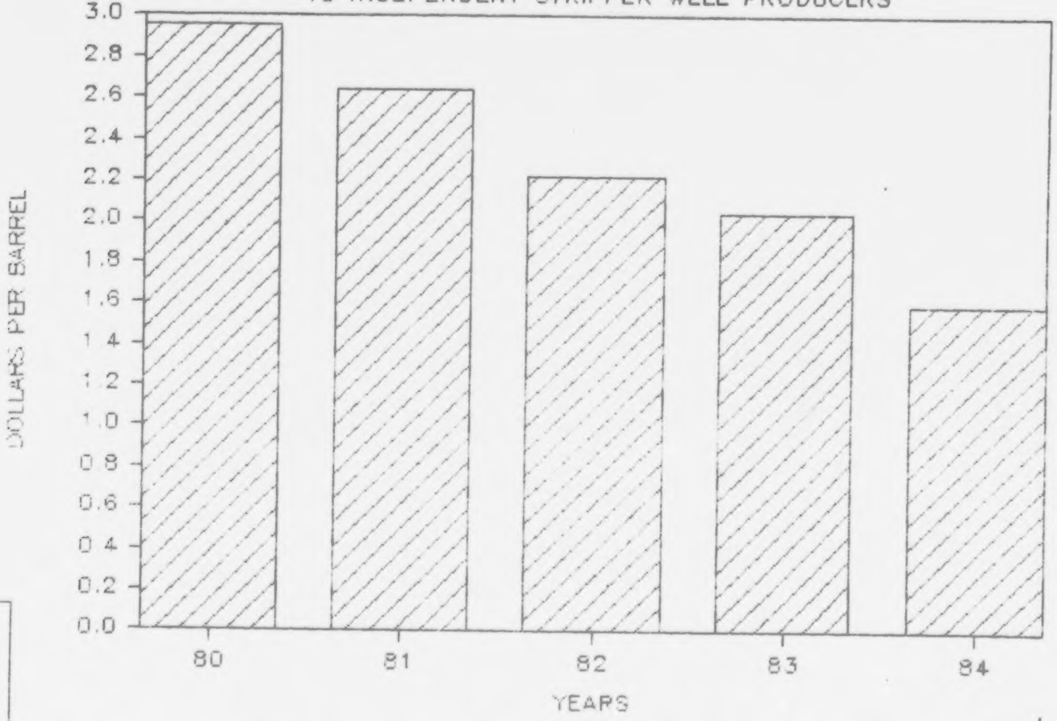
VALUE OF DEPLETION

TO INDEPENDENT STRIPPER WELL PRODUCERS



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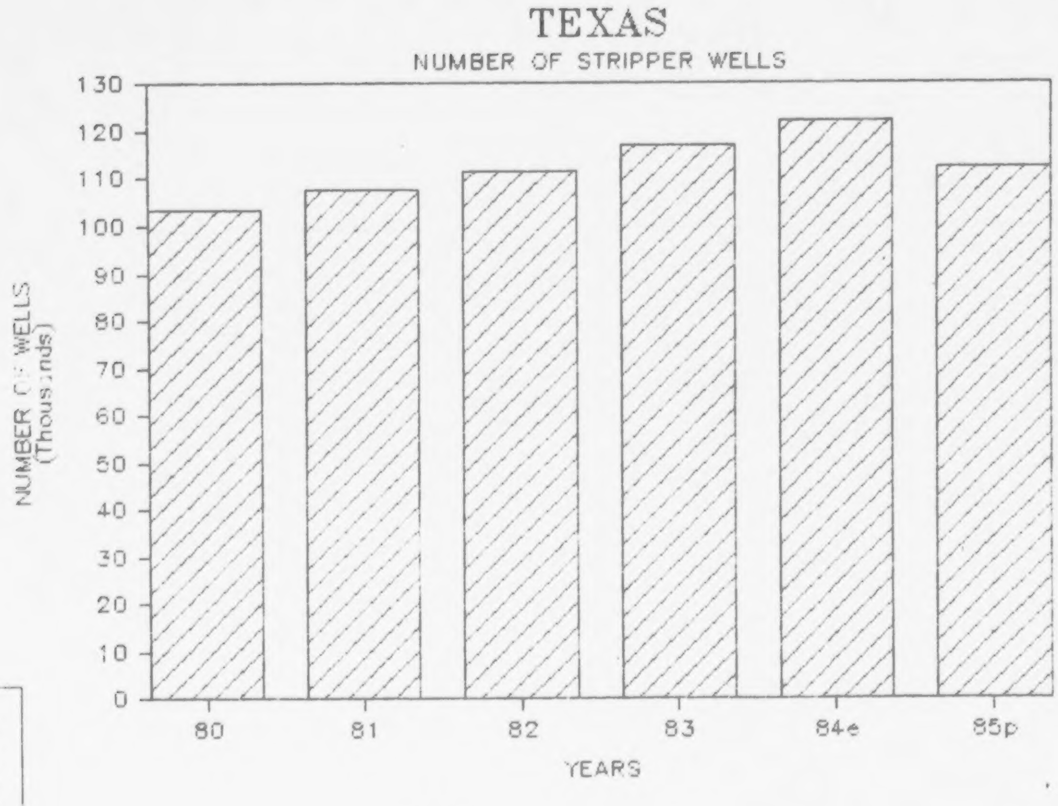

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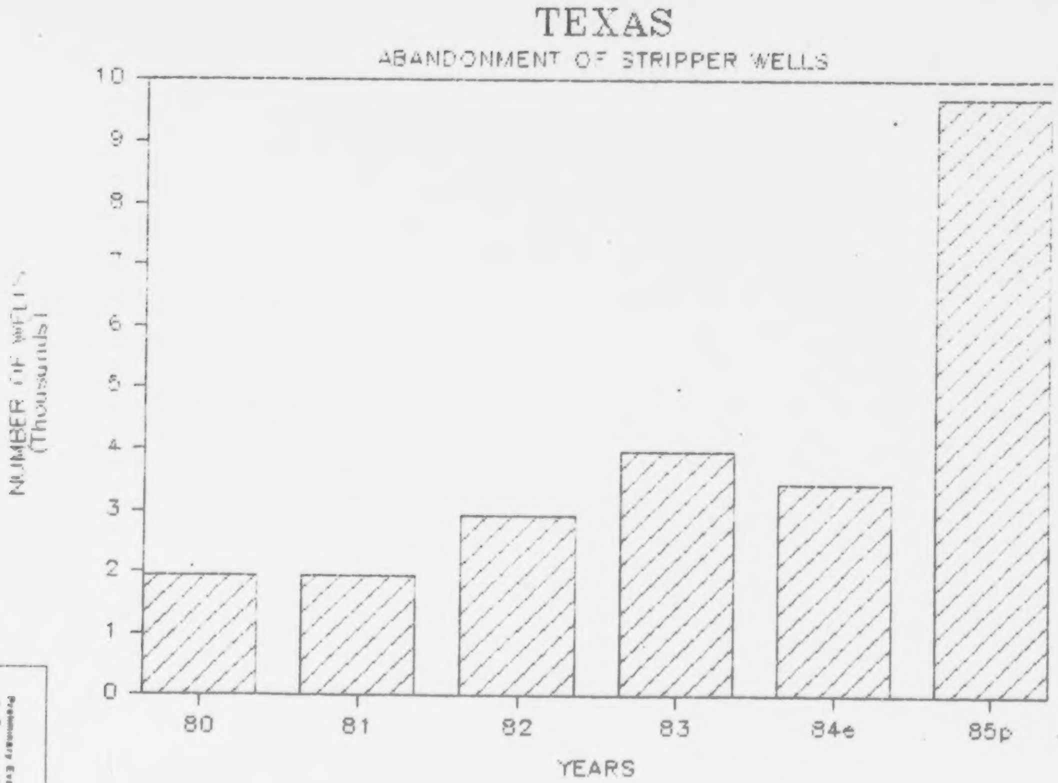

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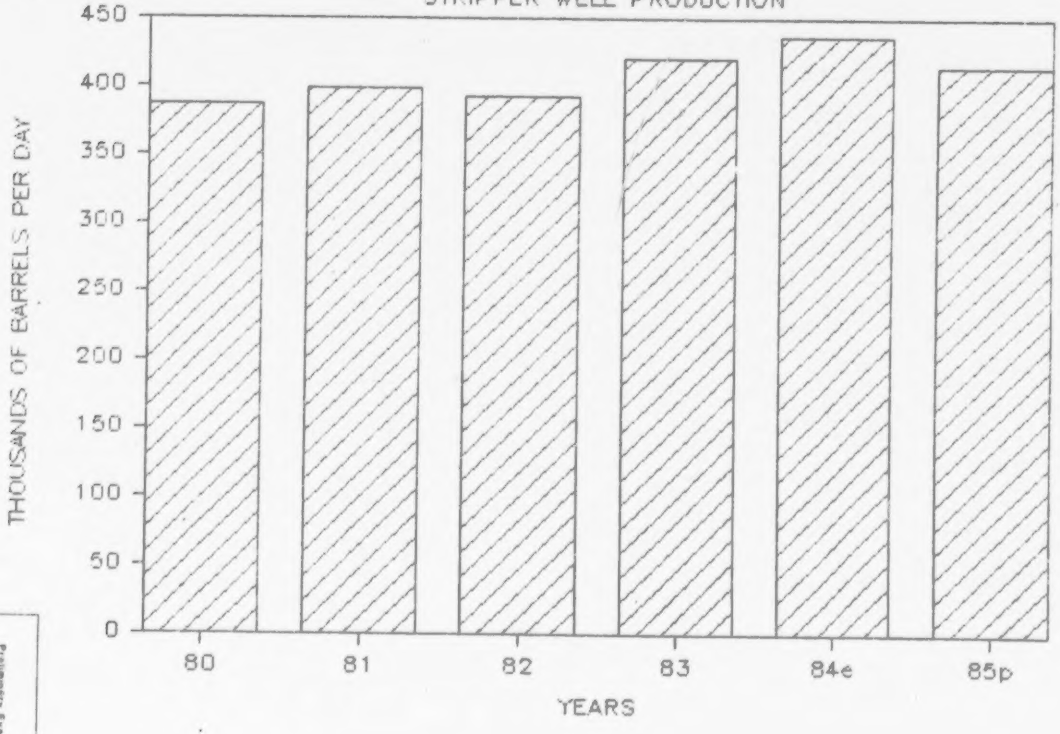
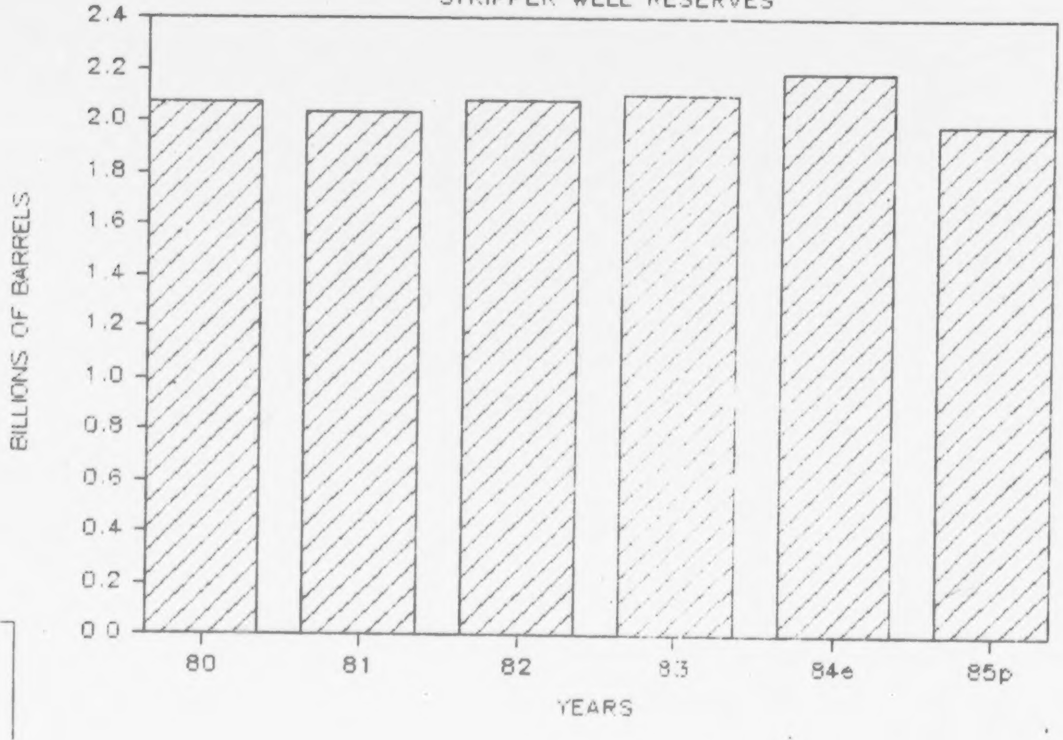
TEXAS

STRIPPER WELL PRODUCTION



TEXAS

STRIPPER WELL RESERVES



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NATIONAL STRIPPER WELL SUMMARY
1954 - 1983

YEAR ENDING DECEMBER 31	NUMBER OF STRIPPER WELLS	NUMBER OF ABANDONMENTS	NUMBER OF ADDITIONS	AVERAGE DAILY PRODUCTION PER WELL (BFD)
1954	327,412	11,318	19,133	3.62
1955	345,126	9,968	27,682	3.68
1956	357,716	8,996	21,586	3.72
1957	359,803	8,651	10,738	3.62
1958	361,062	9,786	11,047	3.88
1959	376,735	11,451	27,124	3.88
1960	403,323	15,434	42,022	3.92
1961	406,102	16,977	19,756	3.99
1962	406,051	16,224	16,173	3.91
1963	401,031	14,363	9,343	3.79
1964	394,107	14,476	7,552	3.72
1965	398,299	15,456	19,648	4.05
1966	380,549	16,207	(1,543)	3.49
1967	376,851	14,986	11,288	3.63
1968	367,205	20,496	10,850	3.62
1969	358,650	15,618	7,063	3.47
1970	359,130	15,631	16,111	3.37
1971	353,696	18,421	12,987	3.58
1972	359,471	13,483	19,258	3.13
1973	355,229	13,756	9,514	2.97
1974	366,095	13,779	24,645	3.08
1975	367,872	13,478	15,255	2.93
1976	365,733	9,916	7,777	2.93
1977	368,930	9,000	12,197	2.91
1978	374,635	8,380	14,085	2.86
1979	386,310	7,668	19,343	2.79
1980	395,176	6,614	15,480	2.77
1981	409,539	7,215	21,578	2.85
1982	416,493	9,426	16,380	2.90
1983	441,501	11,032	36,040	2.87
1954-1983 MEAN	377,994	12,607	16,670	3.40

AVERAGE NUMBER OF ADDITIONS AND ABANDONMENTS 14,639

MEAN STRIPPER WELL PRODUCING LIFE 25.8 YEARS

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STRIPLOW

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	LOW OPERATING COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.5
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.04
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.3
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$4.8
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$5.3
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$5.9
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$6.5
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$6.9
1982	$32.81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$7.4
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$8.1
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$8.8
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$9.6

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETIO ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.38	$5.38	$2.11	$2.69	$3.74	$2.69	$2.69	$1.0
1975	$6.37	$6.37	$2.46	$3.18	$4.42	$3.18	$3.18	$1.2
1976	$6.17	$6.17	$2.50	$3.09	$4.34	$3.09	$3.09	$1.2
1977	$6.81	$6.81	$2.75	$3.40	$4.78	$3.40	$3.40	$1.3
1978	$6.58	$6.58	$2.82	$3.29	$4.70	$3.29	$3.29	$1.4
1979	$13.44	$13.44	$4.60	$6.72	$9.02	$6.72	$6.72	$2.3
1980	$12.26	$18.46	$5.92	$6.13	$12.19	$6.13	$9.23	$2.9
1981	$12.35	$17.56	$5.27	$6.17	$11.42	$6.17	$8.78	$2.6
1982	$11.71	$15.48	$4.43	$5.86	$9.96	$5.86	$7.74	$2.2
1983	$10.30	$15.53	$4.08	$5.15	$9.81	$5.15	$7.77	$2.0
1984	$9.38	$12.24	$3.41	$4.69	$7.83	$4.69	$6.12	$1.7
1985	$8.96	$10.88	$3.32	$4.48	$7.10	$4.48	$5.44	$1.76

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STRIPMID

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	MID OPERATIN COST ($/BBL)
1974	$7.16	$11.20	N.A.	$11.20	$11.20	$1.69	$0.68	$3.7
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.98	$0.79	$4.2
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$4.9
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$5.6
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$6.4
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$7.4
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$8.5
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$9.7
1982	$[illegible].81	$32.75	$20.20	$25.22	$28.99	$4.35	$1.75	$11.
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$12.8
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$14.7
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$16.9

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION MAJOR ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION INDEPENDENT ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION MAJOR ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION INDEPENDENT ($/BBL)	NET EFFECT OF REMOVAL OF DEPLETIC ($/BBL)
1974	$5.19	$5.19	$2.11	$2.59	$3.65	$2.59	$2.59	$1.
1975	$6.14	$6.14	$2.46	$3.07	$4.30	$3.07	$3.07	$1.
1976	$5.66	$5.66	$2.50	$2.83	$4.08	$2.83	$2.83	$1.
1977	$6.01	$6.01	$2.75	$3.00	$4.38	$3.00	$3.00	$1.
1978	$5.47	$5.47	$2.82	$2.73	$4.14	$2.73	$2.73	$1.
1979	$12.00	$12.00	$4.60	$6.00	$8.30	$6.00	$6.00	$2.
1980	$10.28	$16.47	$5.92	$5.14	$11.19	$5.14	$8.24	$2.
1981	$9.50	$14.72	$5.27	$4.75	$9.99	$4.75	$7.36	$2.
1982	$7.91	$11.68	$4.43	$3.96	$8.06	$3.96	$5.84	$2.
1983	$5.58	$10.82	$4.08	$2.79	$7.45	$2.79	$5.41	$2.
1984	$3.49	$6.35	$3.17	$1.74	$4.76	$1.74	$3.17	$1.
1985	$1.64	$3.57	$1.78	$0.82	$2.68	$0.82	$1.78	$0.

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STRIPHIGH

YEAR	AVERAGE CRUDE OIL PRICE ($/BBL)	DECEMBER CRUDE OIL PRICE ($/BBL)	WPT BASE CRUDE OIL PRICE ($/BBL)	NET MAJOR STRIPPER CRUDE OIL PRICE ($/BBL)	NET INDEPENDENT STRIPPER CRUDE OIL PRICE ($/BBL)	ROYALTY ($/BBL)	SEVERANCE TAX ($/BBL)	HIGH OPERATING COST ($/BBL)
1974	$7.16	$11.28	N.A.	$11.28	$11.28	$1.69	$0.68	$3.8
1975	$8.51	$13.18	N.A.	$13.18	$13.18	$1.90	$0.79	$4.5
1976	$9.19	$13.37	N.A.	$13.37	$13.37	$2.01	$0.81	$5.4
1977	$9.98	$14.73	N.A.	$14.73	$14.73	$2.21	$0.89	$6.4
1978	$10.90	$15.10	N.A.	$15.10	$15.10	$2.26	$0.91	$7.6
1979	$15.06	$24.58	N.A.	$24.58	$24.58	$3.69	$1.48	$9.0
1980	$27.55	$37.83	$17.18	$25.44	$31.64	$4.75	$1.91	$10.7
1981	$35.26	$36.22	$18.84	$25.79	$31.01	$4.65	$1.87	$12.74
1982	$32.81	$32.75	$20.26	$25.21	$28.99	$4.35	$1.75	$15.1
1983	$30.08	$30.00	$21.27	$24.76	$30.00	$4.50	$1.81	$17.94
1984	$28.75	$26.75	$21.98	$23.89	$26.75	$4.01	$1.61	$21.29
1985	$26.00	$26.00	$22.79	$24.08	$26.00	$3.90	$1.57	$25.2

YEAR	MAJOR PRODUCER NET PROCEEDS ($/BBL)	INDEPENDENT PRODUCER NET PROCEEDS ($/BBL)	PERCENTAGE DEPLETION ($/BBL)	50% TAX BRACKET AFTER TAX PROCEEDS WITH DEPLETION		50% TAX BRACKET AFTER TAX PROCEEDS WITHOUT DEPLETION		NET EFFECT OF REMOVAL OF DEPLETION ($/BBL)
				MAJOR ($/BBL)	INDEPENDENT ($/BBL)	MAJOR ($/BBL)	INDEPENDENT ($/BBL)	
1974	$5.06	$5.06	$2.11	$2.53	$3.59	$2.53	$2.53	$1.0
1975	$5.85	$5.85	$2.46	$2.92	$4.15	$2.92	$2.92	$1.2
1976	$5.14	$5.14	$2.50	$2.57	$3.82	$2.57	$2.57	$1.2
1977	$5.21	$5.21	$2.75	$2.60	$3.98	$2.60	$2.60	$1.3
1978	$4.30	$4.30	$2.82	$2.15	$3.56	$2.15	$2.15	$1.41
1979	$10.36	$10.36	$4.60	$5.18	$7.48	$5.18	$5.18	$2.3
1980	$8.05	$14.25	$5.92	$4.03	$10.06	$4.03	$7.12	$2.9
1981	$6.54	$11.75	$5.27	$3.27	$8.51	$3.27	$5.87	$2.64
1982	$4.01	$7.78	$3.89	$2.01	$5.83	$2.01	$3.89	$1.94
1983	$0.52	$5.76	$2.88	$0.26	$4.32	$0.26	$2.88	$1.44
1984	($3.02)	($0.16)	($0.08)	($1.51)	($0.12)	($1.51)	($0.08)	($0.04
1985	($6.65)	($4.72)	($2.36)	($3.32)	($3.54)	($3.32)	($2.36)	($1.1

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Senator JOHNSTON. Mr. Brookshire, did you have anything to add?

Mr. BROOKSHIRE. I came up here to answer questions, if I could, if you had any.

Senator JOHNSTON. Thank you. You both have been very helpful to us. We appreciate that.

We have two excellent witnesses left on the agenda, Mr. Jon Massey of the Oil Investment Institute, who is a former staffer of mine, and I know an excellent thinker in this field and a great expert, and also Mr. Francis Durand, who is a consultant with Ernst & Whinney here in New Orleans.

I must apologize to these two witnesses because staff has got to complete the hearing. I've got to go catch an airplane, which I hope I can make in time.

STATEMENT OF JON G. MASSEY, ESQ, ATTORNEY, NEW ORLEANS, LA

Mr. MASSEY. Well, Bennett, I just wanted to say that we appreciate you having this hearing here today. Senator Long has already given my speech, and so has Mr. Moffett, and Mr. Lollar hit on the limited partnership issues.

Senator JOHNSTON. Jon, thank you very much. I know you will add to our record a great deal. We are going to synthesize this record and tell it orally and in writing to our colleagues. It really is, I think, a very strong story that needs to get out.

Thank you very much and my apologies to you and to Mr. Durand for having to go catch a plane.

Staff will complete the hearing. Thank you.

This is Betsy Moler with the staff of the Energy Committee. I know you know Betsy.

Ms. MOLAR. Jon, your full statement, of course, will be put in the record.

Mr. MASSEY. I think that in the interest of time that the full statement will be put into the record, and I think there are about four basic statistics that are necessary to get out and kind of summarize the story that we've heard from a number of witnesses about the importance of the impact of the Treasury proposal on the domestic industry.

The first of these is that the independent segment of the industry provides about 35 percent of the drilling capital that's expended in the United States today.

The second important concept is the independents rely on four sources of capital: Their internal cash flow, sale of equity through stock, banks and sale of equity to nonindustry participants.

Of these segments, cash flow provides about 35 percent of equity of investment by independents. This compares with the major companies who rely on their internal cash flow for about 65 percent of their investment.

Wall Street, through the sale of stock, and the banks are a diminished source of capital for the industry.

I've included in my testimony a chart from the Oil and Gas Journal of January 1985, which reflects that Wall Street and the banks provided a negative $1 billion in capital to the independent sector for funding in 1984.

This minus value results from accelerated recall of loans and scarcity of new loans.

Equity through the sale of stock, for instance, in 1980, nearly $3.3 billion was raised through the sale of stock; in 1984 only $82 million was raised through the sale of stock.

These two sources of capital, equity and banks, are just nonexistent today.

The independent is left with the nonindustry participant as the sole source of outside risk capital. High-bracket taxpayers with disposable income are especially critical to this industry.

My major concern, as appears to be Senator Long's major concern, is the Treasury proposal to tax limited partnerships of more than 35 participants as corporations.

Let me state my concern about the other Treasury proposals affecting oil and gas.

Elimination of immediate expensing of intangible drilling costs would be a death knell to direct investment by nonindustry sources.

I think, however, the Congress will retain some systsm of accelerated cost recovery for oil and gas expenditures.

The critical issue, however, is whether taxpayers will be able to avail themselves of the cost recovery system that Congress enacts.

The imposition of corporate level taxation of limited partnerships will preclude the flowthrough of tax incentives for investment.

The Treasury report is unforgiving in its candor about seeking to increase the cost and risk to nonindustry investors in oil and gas activities through this change.

As was pointed out earlier, I think by Mr. Lollar, the at-risk rules enacted in the 1976 reform do not prohibit a tax of an oil and gas investment from providing in excess of the cost of the investment.

The other thing he pointed out I think is especially important is that we've had three major tax reform measures in the past 4 years aimed at clearing up tax abuses.

Oil and gas is not a tax abuse area. Limited partnerships are not an abuse area in and of themselves. The reform measures that we've passed should be allowed to work, and I think that Mr. Lollar is right in calling for that, and I support that entirely.

That is the basic thrust of what I wanted to say. I think that a crisis arising from oil price erosion because of world factors is probably beyond the reach of Congress to preclude; but an oil and gas financial crisis could as easily arise through precipitous adverse tax legislation.

I think this is an area where Congress can assert its will and avoid this result.

Thank you.

[The prepared statement of Mr. Massey follows:]

THE TREASURY TAX REFORM PROPOSAL
AND CAPITAL FORMATION IN THE INDEPENDENT OIL INDUSTRY

by

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Presented at the Public Hearings

Conducted by the Honorable J. Bennett Johnston

and Russell Long, Senators from Louisiana

New Orleans, LA March 15, 1985

Statement prepared in
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THE TREASURY TAX REFORM PROPOSAL
AND CAPITAL FORMATION IN THE INDEPENDENT OIL INDUSTRY

I am Jon Massey, a New Orleans attorney specializing in oil and gas taxation and investments. Prior to my current practice, I served as General Counsel to the Oil Investment Institute, a national association comprised of independent oil and gas companies who sponsor limited partnership programs. The range of my experience - from formulation of industry positions on tax issues to the raising of funds from banks, institutions and investors - has provided a first hand understanding of the impact of taxation on financial decision making in the independent exploration and production sector.

The importance of independent operations to the domestic exploration and production effort has been widely reported in terms of percentages of wells drilled, number of wildcats, etc. The critical fact for our consideration is that according to the Bureau of the Census Annual Survey, independents make nearly 1/3 of all the expenditures for domestic exploration and production activities. In 1984, the amount for drilling alone exceeded $7 billion. [1]

My reasons for appearing is to state that the ability of independent producers to generate even this level of expenditure will be greatly imperiled if the Treasury's Proposal for Tax Reform is enacted. Independents obtain financing from four sources:

1) Internal cash flow;
2) Equity offerings in the form of stock offerings;
3) Banks and lending institutions, and

4) Direct investment by non-industry participants.

Internal cash flow provides about 35% of funding for independents. This compares with the experience of the major oil companies that generally are able to finance 65% of these exploration and production activities from cash flow. [2]

Equity offerings of stock were an important source of capital four or five years ago when oil prices were strong. In 1980, U.S. oil, gas and energy companies raised $3.3 billion in 72 common stock offerings. In 1984, one common stock offering raised $82.9 million for a non-independent company. [3] As Senator Johnston knows from the hearings in the Senate Energy Committee in the last session, the bulk of Wall Street's interest in the oil and gas area is in mergers and acquisitions. The operative term is "financial restructuring" with exchanges of debt for equity, stock repurchases, asset liquidations, and Chapter 7 and 11 bankruptcy proceedings preoccupying the investment bankers. None of this activity finances the discovery of new petroleum reserves.

From the sidelines, it looks like 1985 will be for banks with significant agricultural loans what 1982-83 was for energy lenders in the Southwest. There are still many problem energy-related loans with most of the critical situations arising in the equipment and lease inventory sectors. If oil prices fall again, we may well see another round of loan defaults. Banks that have been sources of financing have cut back substantially while others have gotten completely out of the energy lending business. The attached chart reflects what I have said about the banks and Wall Street as a source of capital for oil and gas. It records a negative $1 billion in the column for 1984 funding from these sources.

External Funding Sources for Independents

	1981	1982	1983	*1984
		Billion$		
Wall Street and banks	10.4	7.0	0.0	-1.0**
Public, private drilling funds	9.9	2.5	1.5	1.0
Total	20.3	9.5	1.5	0.0
Industry drilling expenditures	36.7	29.0	19.0	22.5
External funds as percent of total expenditures	55.3	32.8	7.9	0.0

*Estimated
**Minus value results from accelerated recall of loans and scarcity of new loans.
Sources: Bureau of the Census, Smith Barney, Walker Energy

(As reported in Parker, Marcia A., "Independent Producers Tapping New Sources of Capital", Oil & Gas Journal, January 7, 1985, pg. 43.)

The reduced access to these sources of financing have left independents with one primary source of non-cash flow capital: non-industry investors. This source has also diminished in the amount contributed. According to the Oil and Gas Journal chart, public and private drilling funds were the source of $9.9 billion in 1981, and only $1 billion in 1984. These investors are the sole source of risk capital available to independents. Securing investment in activities with a high level of uncertainty as to result requires sources with discretionary funds. High bracket taxpayers have more discretionary income and, therefore, the ability to undertake the risks of oil investing.

As the data cited reflects, individuals are an increasingly wary source of capital. There are a litany of reasons: declining oil prices, poor prior investing experience, tax rate changes in 1981, and, now, the fear that Treasury will get its way in Congress and change the tax code to increase the risk to the investor.

The main concern in the Treasury Report is the proposal to tax limited partnerships with more than 35 limited partners as corporations. Please do not mistake my concern about the other Treasury proposals affecting oil and gas activities. The elimination of the immediate expensing of intangible drilling costs would be a death knell to direct investment by most non-industry sources. I think that Congress in its wisdom will retain some system of accelerated cost recovery for oil and gas expenditures. The result maybe treatment similar to the capital cost recovery of other industries through the current ACRS; or oil and gas may have some of its costs recognized as the research and development expenditures they are and retain some immediate expensing.

The critical issue is whether taxpayers will be able to avail themselves of the cost recovery system Congress enacts. The imposition of corporate level taxation on limited partnerships will preclude the flow-though of tax incentives for investment. The Treasury Report is unforgiving in its candor about seeking to increase the cost and risk to non-industry investors in oil and gas activities through this change.

While mounting an attack on oil investment under the guise of "tax shelter abuse," the Treasury report chooses to ignore certain basic facts: (a) that deductions generated by an oil and gas investment can never exceed the cash invested because of the "at risk" rules enacted in 1976, and (b) that the three major tax reform measures in the last four years have eliminated tax reduction as the driving motivation for investment in oil and gas. "Abusive" tax shelters that rely on write-offs well in excess of invested capital should be and have been a matter of concern and legislative redress. It is impossible to structure a multiple write-off investment in oil under the current tax code. Finally, the Treasury proposal to allow only small limited partnerships to receive conduit treatment would create a new unfairness and discrimination based on wealth in the tax code: "tax shelters" would become the privilege of the very wealthy who would be the only ones able to invest the large amounts of capital required in a high cost venture with a small number of participants.

A scholar of the domestic exploration and production business has said that no industrial activity in the U.S. involves the range of uncertainty of the business decisions encountered in the domestic oil business. Oil and gas is not a static activity. The tax code should not be a static document either. Revision and improvement, changes to address the realities of the national economy and the needs of the Federal government are necessary. As reforms are made in the code this year, as I believe they will be, the greater the knowledge and understanding that you Senators and your staffs have, the greater the chances that you will be successful in persuading Congress to enact responsible provisions affecting oil and gas activities.

Having gone through the recent brutal floor fight over agricultural credit in the Senate, I know both of you are familiar with the financial hardships occuring in the farm sector of the economy. The independent exploration business experienced similar disintegration of its economic foundation in 1982-83. Another rapid 20% decline in the price of oil and bailouts for oil banks, financial institutions and producers may become critical. A crisis arising from oil price erosion is probably beyond the reach of Congress to preclude. An oil and gas financial crisis could as easily arise with precipitous adverse tax legislation this Congress can avoid.

NOTES

1. Carey, James H., "Funding the U.S. Petroleum Industry," Oil and Gas Journal, November 8, 1982, p. 160.

2. Ibid., p. 162

3. Energy Comments Year-End 1984, Rotan-Mosle, January 2, 1985, pp. 7-8.

Ms. **Moler**. Thank you. For the record, I should introduce my colleague. He's David Doane, senior counsel for the Committee on Energy and Natural Resources.

I have no questions.

Our last witness, but not least by any means, is Mr. Francis Durand, who is currently serving as a consultant to Ernst & Whinney, he is a former partner with Ernst & Whinney.

I should console you that Andy Rooney does very well from week to week in the cleanup spot on 60 Minutes. I'm sure you will do as well for us.

Sir, proceed as you wish.

STATEMENT OF FRANCIS L. CONSULTANT, ERNST & WHINNEY, NEW ORLEANS, LA

Mr. **Durand**. Thank you. My statement has also been submitted, and I will be very brief.

I'd like to start out by saying that I was in Atlanta last night addressing the Georgia Oil and Gas Association, and I had a brief conversation with the Texas Independent Producers and Royalty Owners Association. I'm vice chairman of that National Energy Policy Committeee.

Both these organizations have asked that I state that they are endorsing substantially with emphasis the remarks I'll make today.

I guess what I would like to do very briefly is look at this proposal in a different manner than other witnesses have. I will go by the old term that, "figures don't lie, although liars sometimes figure."

If you look at the situation that we're looking at, the people who are taking the risks in the oil and gas industry, in order to preserve our Nation's energy resources, are being asked once again to give up something.

I guess what I'd like to do is to point out what it is they are asking to give up. In order to do that, I'll just take a simple illustration, and I made the illustration in an even $100,000. To make it apply, you can multiply it by 10 to be millions, or a 100 it would be 10 million, and so forth.

Let's assume we have an investor A, who is an oil and gas operator. He invests $100,000 a year over 10 years in successful oil and gas ventures. I won't go into the details of what happens. They are in the statement.

Let's look at what happens if another investor also puts $100,000 in a venture which returns to him the same amount of dollars that the investment in the oil and gas venture did.

Let's assume he can write his investment off over a 10-year period. What does it mean with respect to the tax proposal as opposed to the existing taxes today?

The investor in the oil and gas industry is penalized by $22,000 in taxes. The investor in the nonoil and gas venture gets a benefit of $287,000 from the Treasury proposal.

Looking at that from the standpoint of present values, the investor in the oil and gas business has a tax increase of 9 percent, while the investor in the nonrelated oil and gas venture has a tax decrease of 30 percent.

Now, it's awful hard for me to envision how any proposal which is going to penalize the people taking the risk in order to benefit the citizens of the Nation as a whole by increasing our reserves of hydrocarbons can be looked upon and said to be a fair proposal.

Let's look at some of the Treasury's own figures. They propose, or they estimate that this proposal with respect to intangible drilling and development costs alone will raise roughly $5.6 billion from the individual taxpayers and $26.5 billion from corporate taxpayers.

If we go further and say let's assume that intangible drilling and development costs represent 65 percent of the cost of drilling a well, that all of these taxes will be raised from high bracket to highest bracket taxpayer to the benefit of the Treasury, do you know how many wells we're talking about represented by these tax savings over a 5-year period? The total is 192,500 wells.

Let's assume that only a portion of these wells are not drilled. You heard today testimony by several prominent operators who said they would not drill.

So if we take out a small portion of 193,000 wells, our economy is going to be hit very hard from the standpoint of available hydrocarbon reserves.

I'm going very briefly to touch upon the limited partnership proposal. I agree with everyone who has said before that it will kill outside funding. I don't think there's any question about it. I have seen it already.

I know I can cite you a situation, if you'd like, of one of these master limited partnerships which was mentioned earlier. This master limited partnership came out in early 1984. It was selling very well, selling at about the exchange offering price of around $20 per unit.

After this proposal came out, the last time I looked at it it was at $12 per unit. I guarantee you it's not raising much money.

I would like to say one more thing. We have a book which has been published in connection with oil and gas, and in that book there is an example of an oil and gas operator and certain economics with respect to his operations over a 5-year period.

We recently have just updated, or are in the process of updating this particular book, and as a start, an article will be published in the trade journal. I decided I would take that article, or the statistics in that book, and see what this Treasury proposal would do to it.

There has been nothing involved, no relation of this to the Treasury proposal at all. So it wasn't weighted in any means.

To give you a simple example, an operator spent $135 million, roughly, on—$136 million, I'm sorry, on exploration, drilling, acquiring properties. He was very successful.

He was able to obtain reserves, add reserves of 17,600,000 barrels. I can assure you that is very low finding cost compared to what the average is today.

Yet in spite of that, that operator had to come up with $20 million cash out of his pocket. In other words, his cash flow was $20 million short in the first 2 years, in order to fund that program.

At the end of 5 years, he was still short an accumulative cash flow by $4½ million.

The Treasury proposal would serve to add $15 million to that deficit. What do you think such a thing is going to do with respect to oil and gas exploratory and development activities, particularly exploratory?

I guess I might very simply add it up. If you take the examples I have set forth before you, if you were spending the money, if you had to make a decision as to what you were going to get back for that money, and if you could get back a 30-percent return by a lower tax bracket, as opposed to adding 10 percent to your tax loss, where would you spend the money?

That is the type of economic decision oil and gas investors are going to be faced with.

In conclusion, there's no question about the fact that the search for hydrocarbon reserves is becoming more difficult. It's more risky and it's more costly, because the more you find, the less there is to find.

It doesn't make good sense to hamper the efforts to find new reserves by adding to the tax burden of the operator.

That's the conclusion of my statement.

[The prepared statement of Mr. Durand follows:]

PREPARED STATEMENT FOR SENATE ENERGY COMMITTEE

HEARING ON TREASURY'S TAX PROPOSAL

Francis L. Durand, CPA
Ernst & Whinney
Vice Chairman for Taxation
National Energy Policy Committee--TIPRO

The following statement has been endorsed by the Texas Independent Producers and Royalty Owners Association and the Georgia Oil and Gas Association.

The Treasury's proposed revision of the Internal Revenue Code (IRC) may be labeled a "tax simplification" proposal but, in effect, it is one which may result in extremely adverse consequences to our Nation's dependency on foreign sources of energy from hydrocarbon reserves.

The IRC currently contains certain provisions which may be looked upon as "incentive" provisions with respect to investments in, and operations of, oil and gas properties. Two of the principal provisions involved provide tax benefits applicable to deductions for intangible drilling and development costs (IDC) and percentage depletion. The Treasury's proposal eliminates such benefits. Without the available benefits applicable to such so-called "incentive" provisions, it is entirely possible that an economic evaluation of proposed exploratory efforts would lead to a management decision to invest funds otherwise.

To illustrate the conclusion drawn above, assume that the following circumstances exist:

(1) Mr. A, an oil and gas operator invests $100,000 per year, over a ten-year period, in oil and gas ventures with such costs being allocated on the basis of 5% to leasehold costs, 30% to equipment and 65% to IDC.

(2) The ventures are successful and 150,000 MCF of gas are discovered each year which will be produced at a rate of 20% the first year with a gradual decline over the ensuing nine years.

(3) The sales price for gas production is $3.00 per MCF (no escalation), severance taxes are 7.5% of the sales price and lease operating expenses are $6,000 per year (with respect to each venture).

(4) Mr. B invests $100,000 each year over a ten-year period which provides him with a pre-tax return equivalent to that obtained by Mr. A. it is assumed that his investment can be amortized ratably, for income tax purposes, over ten years in proportion to the return he receives each year.

(5) Messrs. A and B are taxpayers in the 50% income tax bracket and will have no liability for minimum taxes, under provisions of the IRC, during the ten-year periods referred to above.

Based on the foregoing assumptions, the following table illustrates the estimated change in each taxpayer's future tax liabilities for the applicable ten-year period, as a result of the Treasury's proposal:

	Mr. A	Mr. B
Total Tax Liabilities:		
Increase (decrease) - amount	$21,770	$(287,309)
Increase (decrease) - percent	3.3%	(30.0)%
Present Value of Total Tax Liabilities:		
Increase (decrease) - amount	$31,206	$(153,145)
Increase (decrease) - percent	9.2%	(30.0)%

The oil and gas operator is taking a risk whenever he drills a well, particularly with respect to an exploratory well. At the present time, the oil and gas industry is faced with adverse economic conditions as to exploratory and production activities due to declining product prices. It is extremely difficult to view the Treasury's proposal as logical when it adds additional burden on the investors in such activities. In light of the differences in tax liabilities under the preceding illustration, the return on the investment attributable to a non-oil and gas venture, as compared to that attributable to an oil and gas venture, coupled with the substantial risk associated with the oil and gas venture, could lead to decisions which will divert substantial funds from investment in oil and gas exploration and production activities. Such decisions under the Treasury proposal might make good economic sense for the operator; however, it is certainly detrimental with respect to the Nation's future dependency upon domestic energy resources.

The Treasury proposal provides estimates that elimination of the IDC deduction will increase revenues over the five-year period beginning with 1986 by $5.597 billion with respect to individual taxpayers and $26.527 billion with respect to corporate taxpayers. If it is assumed that such estimates are based on the highest existing tax rates, that IDC expenditures represent 65%

of the cost of drilling a well and that the average cost of drilling a well is $550,000, such estimates can be related to the drilling of approximately 192,500 wells. What would happen to the Nation's available resources of hydrocarbon energy if a substantial portion of the 192,500 wells were not drilled due to a diversion of the required funds? The answer to such a question could lead to a conclusion that increased dependency on foreign sources of such energy may result.

As previously noted, the independent oil and gas operator's existing cash flow is presently adversely affected by declining prices. Funding of exploration and development activities is often provided by investors in limited partnerships. The Treasury proposal contains a provision which will have an extremely adverse impact on this source of funds by treating partnerships with more than 35 limited partners as corporations for income tax purposes. That provision could substantially reduce, if not eliminate, this source of funding exploration and development activities.

An analysis was made of assumed oil and gas exploratory activities of a corporate entity which involved investment of approximately $136,000,000 in lease acquisition and drilling of wells over a five-year period. Such investment was assumed to have discovered total oil reserves of about 17,600,000 barrels. Prices per barrel were escalated from $28 in the first year up to $34 in the fifth year. Other assumptions were made applicable to dry hole and abandonment costs, operating costs, administrative costs, severance and windfall profit taxes, etc., which are not detailed herein. The analysis indicated the following (in thousands):

	Computations Based On		
	Existing Statutes	Treasury Proposal	Increase (Decrease)
Cash Flow (Deficit):			
Year 1	$(13,530)	$(13,530)	$ -
Year 2	(6,471)	(7,405)	(934)
Year 3	247	(3,675)	(3,922)
Year 4	3,948	(2,456)	(6,404)
Year 5	11,329	7,357	(3,972)
TOTAL	$ (4,477)	$(19,709)	$(15,232)

The foregoing analysis indicates that the oil and gas operator was required to provide funding of about $20 million dollars during the first two years applicable to maintaining his exploratory program and was still in a cumulative cash deficit position of almost $4.5 million at the end of five years. Such results were applicable to computations under existing tax statutes. When comparable computations are made under the Treasury's proposed revisions to the IRC, the oil and gas operator's cumulative cash deficit position is increased by over $15 million.

The assumptions used to make the computations discussed above were applicable to an illustration related to an article to be published in a trade journal which was not in any way connected with the Treasury's proposal. On many occasions, an oil and gas operator's finding costs are much higher than those applicable to the illustration. The results of such computations are presented herein to further illustrate the detrimental impact which the Treasury proposal can have on decisions to pursue oil and gas exploratory activities.

In conclusion, it should be pointed out that the search for hydrocarbon reserves is becoming more difficult, much riskier and more costly as such reserves become scarcer. It does not make good sense to hamper the efforts to find new reserves by increasing the operator's tax burden.

Ms. **Moler**. Thank you very much.

As Senator Johnston indicated earlier, the hearing record will be left open for submission of additional statements.

Thank you and good afternoon.

[Whereupon, at 4:45 p.m., the hearing was adjourned.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

March 15, 1985

Mr. Chairman:

I'm Nick Perez, President of the Louisiana Retailers Association, an organization representing some 1500 firms in the retail industry.

Retailers are traditionally high rate tax payers; therefore, I appreciate this opportunity to express some of the feelings and thoughts of our members.

We endorse the concept of simplifying the tax laws, broadening the base, and lowering rates. This is the essence of entrepreneurship and free enterprise.

We also ask that Congress proceed with caution. Our economy is the result of a balance between many factors. Any change will affect that balance.

A brief description of the retail industry in Louisiana will show what is at stake.

The following figures are for the year 1983:

Retailing is the 3rd largest source of jobs, behind government and services. It represents 267,700 jobs, or 17% of the work force. Considering that (1) government doesn't pay taxes, (2) that the category of services represents a divesified group, of which many are employed by retailers such as restaurants and hotels/motels; it can be said that retailing is the largest, single, indentifiable industry to be impacted by the tax reform.

Retailing in Louisiana is primarily by small business entrepreneurs - - the main street family business. They represent 80% of our membership. Small businesses provide 2 out of every 3 new jobs created. The needs of these owners are often quite different from the needs of owners of large businesses. These differences must be kept in mind when considering the tax reforms.

The ripple effect of an expanding retail industry must also be considered: New stores mean new construction jobs, turnover opportunities for landowners, sales by suppliers, movement of investment capital, additional revenues to taxing bodies. A shrinking retail industry means the opposite.

It is also understood that the sales and payroll dollars of retailing exchanges hands several times throughout our economy.

Retailing provides a strong impetus to the economy. Many recognize that consumer spending represents the largest single factor in the recovery from the latest recession.

LOUISIANA RETAILERS ASSOCIATION POST OFFICE BOX 44034 • TELEPHONE (504) 344-9481 • BATON ROUGE, LA 70804

Gentlemen, we ask that you be thoughtful in your deliberations of specific items in the reform proposals such as:

- Corporate Tax Reduction
- Cost Recovery
- Dividend Deductions
- Indexing of Interest Rates
- Employee Benefits

We endorse the concept of reform and we reserve comments on specific proposals until sufficient information is obtained and the results of each can be determined.

For the benefit of all, we ask that the final product help keep entrepreneurship, that spirit which has made America so great, alive.

On behalf of the members of the Louisiana Retailers Association, I thank you for your attention and this opportunity to speak to you.

LOUISIANA FACTS -- 1983

RETAIL ROLE IN LOUISIANA ECONOMY	PERSONS EMPLOYED	% TOTAL
TOTAL EMPLOYMENT	1,587,000	100%
GOVERNMENT	311,000	20
SERVICES	306,900	19
RETAIL TRADE	**267,700**	**17**
CONSTRUCTION	115,500	7
NONDURABLE MANUFACTURING	102,300	6
WHOLESALE TRADE	99,500	6
DURABLE MANUFACTURING	89,100	6
FINANCE/INSURANCE/REAL ESTATE	80,300	5
OTHER	214,500	14

SOURCE: BUREAU OF LABOR STATISTICS

Shell Oil Company

One Shell Plaza
P. O. Box 2463
Houston, Texas 77001

Donald G. Russell
Vice President Production

March 22, 1985

The Honorable J. Bennett Johnston
United States Senate
SH-136 Hart Senate Office Building
Washington, DC 20510

Dear Senator Johnston:

I am writing to request on behalf of Shell Oil Company that the attached statement outlining concerns about the Treasury Department's "tax reform" proposal be included as a part of your Committee's hearing record for the Committee's New Orleans hearing on March 15, 1985.

Although it was not possible for Shell to testify at the hearing, we appreciate the fact that the Senate Energy Committee is interested in the impact of the Treasury Department's proposal on energy exploration and development. Indeed, we hope that you and other members of the Senate Energy Committee will continue to monitor developments with respect to the Treasury proposal as to the possible impact on national energy security.

As we indicate in our statement, we are particularly concerned about the impact of the Treasury proposals on enhanced oil recovery, an important component of future energy supply. Our analysis shows that the elimination of the deduction for "qualified tertiary injectants," together with other plan proposals, would have the same negative impact on project economics as a $5 per barrel reduction in crude oil price and this would render many projects uneconomic, and could result in the loss of 10 billion barrels of oil reserves.

We hope that the attached statement will be helpful to you and other members of the Committee as you proceed to study this important matter.

Sincerely,

Donald G. Russell

SBL:rs
Attachment
cc: John S. Herrington, Secretary of Energy
James A. Baker, Secretary of the Treasury

STATEMENT BY SHELL OIL COMPANY
PREPARED FOR
THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

We appreciate the opportunity to submit this statement on the effects of the proposed Treasury tax simplification plan on the domestic oil and gas industry.

While we can all agree that greater public confidence in our tax system is essential, the nation should approach the task of tax simplification with great care. The consequences for the economy -- and for the petroleum industry in particular -- could be profound, and we must be wary of changes that would destroy the necessary stimulus to invest, create jobs, and provide for this country's energy needs.

The Treasury proposal contains some recommendations that would certainly be constructive. For example:

-- A reduction of the corporate tax rate;

-- Partial relief from double taxation of dividends, and

-- Indexation of investment for depreciation and capital gains purposes.

Unfortunately, the positive effects of these constructive recommendations would be overshadowed by other parts of the plan that would have a far different impact. Any business that must invest heavily to compete and survive would be directly hit by two major changes:

-- Repeal of the Investment Tax Credit, and
-- Replacement of the Accelerated Cost Recovery System, just enacted in 1981, with a slower Real Cost Recovery System.

As serious as these proposals are for business in general, the plan's effect on the domestic oil and gas industry would be even more severe.

The petroleum industry, like any capital-intensive industry, would be hard hit by the loss of the Investment Tax Credit and the Accelerated Cost Recovery System. But, in addition, several changes in the Treasury plan would be seriously and specifically detrimental to the nation's oil and gas industry. For example:

-- Loss of the ability to expense intangible drilling costs would have a substantial negative impact on cash flow; exploration and exploratory drilling activities would quickly decline.
-- Loss of the ability to expense the cost of so-called "qualified tertiary injectants" used for enhanced oil recovery would severely hamper applications of new technology to existing reservoirs.

It is important to note that both of these items are recurring expenses for a petroleum company engaged in enhanced oil recovery.

Since this plan would have such a negative impact on a key sector of the economy, we would have to believe that it reflects a basic misunderstanding of our industry. This is confirmed by the rationale outlined in one section of the plan dealing with intangible drilling costs. The Treasury plan states that:

> "Drilling is favored relative to less expensive means of exploration that are not tax preferred." According to the report, present law promotes "an excessive reliance on drilling, and an inadequate utilization of seismic and other more technologically advanced methods of exploration."

The clear implication of this statement is that the petroleum industry undertakes a drilling operation strictly for tax reasons. The facts are, however, that drilling is the only way to confirm the presence of oil or gas that is, at best, only suspected by any of the alternative techniques the Treasury plan seems to prefer. With today's high cost of drilling in the most promising frontier areas -- for example, the approximate $150 million cost of the Mukluk well and the nearly $30 million average cost of the offshore Atlantic wells -- it is preposterous to suggest that the industry would begin drilling on a new primary exploration project without having exhausted all of the most "technologically advanced" methods of exploration. In reality, drilling for oil and gas represents an ordinary and necessary annual recurring expense for a petroleum company.

The Treasury proposal also misrepresents the market mechanism for produced goods, as it applies to petroleum: It states that "benefits of tax deferral tend to be reflected in the prices of the products produced by multiperiod processes." In most extractive industries -- petroleum in particular -- the price is set by world competition, and an individual producer in the U.S. is fighting a continual battle to stay in the market. The U.S. can be described as a "mature" resource area for crude oil and natural gas, which means that our new reserves tend to cost more to find and produce than those in other areas of the world. The current deductions for major recurring costs help new domestic sources of production to be developed that would otherwise not become available.

From the preliminary reports we have seen, we believe that the Treasury proposals could effectively eliminate a significant amount of new investment in our industry. Furthermore, the effects would not be uniform or consistent --

some potential sources of oil and gas reserves would be affected much more seriously than others.

The effects of these proposals on the domestic petroleum industry -- and thus on domestic production, imports and this nation's energy security -- are being documented by a growing body of data. Analyses and reports are being made by the Department of Energy, the Interstate Oil Compact Commission, the American Petroleum Institute, and many other groups and companies.

As one of the pioneers in the field of enhanced oil recovery, Shell Oil Company is especially alarmed about the effects of the Treasury proposals on the use of enhanced oil recovery methods to produce greater amounts of oil from known reservoirs. Therefore, while we certainly don't want to imply that other aspects are not important, we will concentrate our remarks on the impact on enhanced oil recovery.

First, let us define what we mean by enhanced oil recovery (EOR). Conventional, or primary recovery, and secondary recovery methods such as waterflooding, in general can recover only about one third of the oil originally in place in the reservoir. Much of the other two-thirds of the oil originally in place is not producible by these methods because of the characteristics of the oil or the geology of the reservoirs in which it is located. A portion of this remaining resource constitutes the target for enhanced oil recovery. These are technologically advanced processes -- involving chemicals, thermal heating or miscible fluids -- to recover additional oil which otherwise would remain in the ground. Recovery from enhanced oil recovery methods currently amounts to 460,000 barrels a day, or about 6 percent of total U.S. oil production.

It is somewhat ironic that the Treasury proposals were announced less than six months after the release of a major new National Petroleum Council report on enhanced oil recovery. The NPC report, made at the request of the Secretary of Energy, estimated that 14.5 billion barrels of oil can be recovered from exisitng fields through enhanced oil recovery -- with current technology and at current prices. About 3.5 billion barrels would be produced through EOR projects already undertaken, and an additional 11 billion barrels could be added to the domestic crude oil supply from existing fields through new projects. This net addition to the domestic crude oil supply is equivalent to approximately 40 percent of the current recoverable U. S. reserves.

If one considers the additional recovery that could result from technology advancements that will probably occur over the next several decades, the potential ultimate recovery from enhanced recovery methods -- at today's prices -- increases to 27.5 billion barrels -- almost doubling current proved oil reserves.

Shell's analysis shows that the Treasury tax proposals -- including but not limited to the repeal of expensing for "tertiary injectants" -- would adversely affect the economics of enhanced oil recovery projects to the extent that a major portion may never be undertaken. This would substantially reduce an important component of the petroleum supply picture over the next 30 years. The elements of the Treasury tax plan which were used in our analysis are:

- Elimination of investment tax credit;
- Replacement of intangible drilling costs expensing provision with cost depletion;
- Replacement of "qualified tertiary [EOR] injectant" expensing provisions with cost depletion;

- -- Revision of the depreciation system from current Accelerated Cost Recovery System (ACRS) to approximate the system called Real Cost Recovery System (RCRS);
- -- Reduction of tax rate from 46% to 33%;

For evaluating the proposed tax changes, we used economic premises which are consistent with a recent study by Data Resources, Inc. (DRI) on The Outlook for Oil/Gas Prices, Drilling and Production.

We have analyzed what we consider to be representative onshore enhanced oil recovery projects under both the existing tax provisions and the Treasury plan. In our analysis, the rate of return for enhanced recovery projects -- a common measure of profitability -- would be reduced by about 4 percentage points under the Treasury proposals. An enhanced recovery project with a 10 percent real rate of return would earn only 6 percent under the Treasury plan. Our study shows that the Treasury plan would have the same negative impact on project economics as a $5 per barrel reduction in crude oil price and this would render many projects uneconomic.

There are specialized investment characteristics of enhanced oil recovery projects which would be significantly affected by the Treasury proposals. The challenge with enhanced recovery is to conceptualize and develop a process or operating plan that will enable us to economically produce this oil. The processes for enhanced recovery are still developing and are quite expensive. Therefore, the economics of enhanced oil recovery methods are sensitive to even small changes in prices or tax burdens.

The experimental nature of the processes, and the need for ongoing development and engineering efforts, calls for a more constant level of investment throughout the project life, as opposed to "up-front" expenses.

Engineering economics also require a stepwise program in thermal recovery, for example, so that expensive facilities can be used for injecting into a succession of project areas or "patterns."

The high costs associated with enhanced recovery projects include items also common to primary recovery, as well as to secondary recovery processes such as waterfloods. These include well drilling and completion costs, surface handling equipment, general lease operating costs, and so on. There are also significant additional costs specifically associated with the particular enhanced recovery process being implemented.

For example, the carbon dioxide miscible process -- used for several current and planned Shell projects -- requires major investment for handling the CO_2 injectant. In our West Texas project, a significant investment is being made in Colorado for wells and facilities to develop a CO_2 source. In addition, a 500-mile pipeline was built to West Texas to deliver the CO_2 to the project area. A major investment was also made for processing produced gas and recycling CO_2 injectant in the project area itself. The cost of CO_2 for injection has been the major expense item for this project.

Another important investment characteristic to consider in these ventures is the "project life." Enhanced oil recovery projects will generally have a much longer project life than conventional recovery, on the order of 30 to 40 years. One of the cases we analyzed has an expected life of 34 years and the other a 39-year project life.

Considerable time and cost must usually be expended during injection before production response is achieved. As a result, the production from enhanced oil recovery will tend to increase slowly to a maximum rate that will be sustained for many years.

The Treasury proposal would take many of these expenditures -- such as dry hole costs, intangible drilling costs, and the costs of "qualified tertiary" injectants for enhanced recovery -- and change the method of recovery from the fastest (essentially as the money is spent) to the slowest (over the life of the entire property). Cost depletion provides for much slower capital recovery than does the depreciation method proposed for capital expenditures.

By forcing enhanced recovery projects to recover costs over this extended project life -- up to 40 years -- the Treasury plan would significantly reduce the cash flow available to new projects and to existing projects that require ongoing investments to continue the efforts necessary to economically complete the recovery process.

The importance of these results is not simply on the economics of a single project. They portend a significant reduction in this country's future energy supply.

The NPC study investigated the effects of changes in crude oil prices on total U.S. enhanced oil recovery. It concluded that if prices dropped by as much as $10 per barrel from current levels, the industry ultimate recovery would be reduced to about 7.4 billion barrels. This represents a loss of 7.1 billion barrels based on implemented technology. Further, if the economics of enhanced oil recovery were to be impaired by the equivalent of a $10 price cut, essentially no advanced technology projects could be undertaken, resulting in a further loss of 13 billion barrels.

As determined from our analysis, the Treasury proposal would have the same impact as a $5 loss in oil prices. This suggests that about half of the potential seen in the NPC study -- or some 10 billion barrels -- would be rendered uneconomic. Compared with recent exploration experience, this potential loss in enhanced recovery reserves would be equivalent to 10 years of additions to proved crude oil reserves in the U.S. from primary development.

It is important to note that in many cases, the loss from delaying enhanced recovery operations -- whether from economic or technological barriers -- is difficult or impossible to recoup later. The NPC study refers to this as the "lost opportunity" issue.

All states have statutes or regulations requiring oil and gas wells to be plugged after production ceases to avoid pollution. The rights of operators under oil and gas leases also generally terminate if a property becomes uneconomic to produce. Even if the disincentives contained in the Treasury proposal were reversed by future legislation, many enhanced recovery projects might be lost in the interim.

One purpose implied in the Treasury proposal is to preserve the same level of total tax revenues by increases in some businesses and decreases in others. This abstraction might make sense if the U.S. had a self-sufficient "closed" economy. Things are not so simple with basic industries such as oil and natural gas in which significant volumes must be imported to satisfy domestic requirements. Adoption of measures proposed by the Treasury would have the immediate effect of reducing oil and gas production, increasing imports, and thus endangering our current somewhat precarious level of energy security.

The petroleum industry is constantly pursuing technological innovation, especially in the area of enhanced oil recovery. The current law recognizes this and allows us to deduct on a current basis the cost of "qualified tertiary" injectant expenses for enhanced oil recovery projects. The Treasury Plan would repeal the expense provision and afford these expenses depletion treatment on a unit of production basis. This disincentive is contrary to the

Treasury's stated position of creating incentives for technological innovation. The research and development tax credit -- much more valuable than a deduction -- would be extended under the Treasury plan for most manufacturing companies, but would not be applicable to our enhanced oil recovery projects.

Treasury Secretary Baker has said that he was willing to reexamine all provisions of the Treasury package. He said "compelling reasons to the contrary" would be required before any of the proposals were dropped.

We believe the importance of future domestic energy supplies -- particularly the large potential for additional oil from the technological innovation associated with enhanced oil recovery -- provide those compelling reasons.

We propose the Treasury reconsider their position and retain the current expensing treatment for tertiary injectants and other provisions necessary to the achievement of the potential for enhanced oil recovery.

The degree to which enhanced oil recovery methods are applicable in the future depends on the continued development of improved process technology. The Treasury Plan should encourage the overall advance of technology with consistent tax policy.

# # #